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Report of the
**Auditor General
of Canada**
to the House of Commons

Foreword and Main Points

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

Foreword and Main Points



May 1995

This May 1995 Report comprises 8 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this document.



AUDITOR GENERAL OF CANADA

VÉRIFICATEUR GÉNÉRAL DU CANADA

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my first Report of 1995 to the House of Commons, to be laid before the House in accordance with the provisions of section 7(5) of the *Auditor General Act*.

A handwritten signature in cursive script, reading "L. Denis Desautels".

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 11 May 1995

Foreword and Main Points

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Report of the Auditor General to the House of Commons for May 1995

Foreword

In June 1994 the *Auditor General Act* was amended to provide authority to table each year one annual report, not more than three additional reports, and any special reports on matters of pressing importance or urgency.

My Office views this amendment as an opportunity to improve our service to Parliament. When we were limited to one annual report, members of Parliament were sometimes asked to deal with material that was no longer current. Having the authority to issue up to three additional reports a year will mean that we can provide more timely and relevant information on the results of our work.

Parliament's ability to address our audits without undue delay means that corrective action can be taken sooner and potential savings to the taxpayer increased. Because of the urgent need to reduce government deficits and the public debt, it is important for Parliament and the government to be able to demonstrate that identified opportunities for savings will be acted on swiftly.

I am pleased to table our first "additional report". In addition to this Foreword and the Main Points that follow, there are eight chapters, issued separately:

- Ethics and Fraud Awareness in Government
- Environment Canada: Managing the Legacy of Hazardous Wastes
- Federal Radioactive Waste Management
- Health Canada: Management of the Change Initiative at Health Protection Branch
- Office of the Superintendent of Financial Institutions — Deposit-taking Institutions Sector
- Federal Transportation Subsidies
 - The *Western Grain Transportation Act* Program
 - The Atlantic Region Freight Assistance Program
- Travel and Hospitality
- Travel Under Foreign Service Directives

We will try to schedule our tabling dates to be reasonably regular and at a time when it is convenient for parliamentarians to deal with the reports — that is, at least one month before a scheduled recess and no sooner than two weeks after the House resumes sitting. Furthermore, in the course of our normal planning of audits, we will try to harmonize our reports with departmental activities that are directed to Parliament. This is intended to maximize departments' ability to respond in a timely way to our reports.

This year we will issue another "additional" report in early fall, and our annual Report as usual in late November. In future years we plan to table not more than three reports, but not necessarily three, in addition to the annual Report. My Office is also going to be responsible for preparing the annual report of the Commissioner of the Environment, and the impact on our reporting process and resources has yet to be seen.

Foreword (cont'd)

In this and future reports, chapters will be bound individually or grouped with others that address a similar subject with the same expected readership. In 1994 we experimented with separately bound chapters and determined that our readers found them more convenient to use and reference. In particular, the separate binding reduces the distribution of unneeded chapter copies. Our reports will continue to be available in electronic format and accessible on Internet.

I will continue to draw broad conclusions and highlight significant issues in my chapter entitled "Matters of Special Importance and Interest", which will continue to be published in the annual Report. Generally, that report will also include "Other Audit Observations" and our regular follow-up on previous years' audit chapters. However, there may be occasions when, for reasons of subject matter or timing, it will be advantageous to publish some of that material with an audit chapter on the department concerned.

After the first yearly cycle of reports, I will undertake to consult with parliamentary committees and other members of Parliament as appropriate, to determine whether our scheduling of reports has been generally satisfactory or can be improved. We will also review the impact on departmental operations.

Our overriding goal is to make our service to Parliament as timely and relevant as possible. The amendments to the *Auditor General Act* have brought us closer to achieving that goal.



Ethics and Fraud Awareness in Government

Assistant Auditor General: Richard B. Fadden
Responsible Auditor: Alan R. Gilmore

Chapter 1 – Main Points

- 1.1** Canadians are concerned about integrity in government and they have the right to expect the highest ethical standards in their governments. However, they also need to appreciate that they have raised similar concerns about the ethical standards of a number of other institutions and occupations and that these ethical standards, as well as their own, influence those in government.
- 1.2** We did not undertake this study because we believe that ethical standards in Canadian governments are declining or are worse than those in the private sector. The expectations of Canadians for ethical conduct in the public sector are probably greater than for most of the private sector.
- 1.3** Nor did we undertake this study because we believe that ethical standards in Canadian governments are worse than those of other countries. We believe that Canadian governments compare very favourably with others in their integrity.
- 1.4** However, Canadians are concerned about integrity in government. If Canadians do not trust their governments to act ethically, governments will find that their actions have less and less legitimacy and effectiveness. Thus, we believe that it is important to discuss ethics in government and to take action to maintain and promote ethics in government.
- 1.5** The chapter addresses only a part of the subject of ethics in government — ethics in decision making. Ethics in decision making means that decisions are made impartially and objectively, and in the public interest.
- 1.6** The chapter proposes a framework for ethics in government that recognizes the importance of existing government measures and reflects the results of extensive interviews with public servants about ethics and fraud awareness. The objective of this framework is to help ensure that the principle that public service is a public trust is the cornerstone of Canadian public administration.
- 1.7** The chapter also reports the results of our interviews with public servants in four departments. The results indicate that we are starting from a strong base of ethical standards among public servants. However, we found some areas of vulnerability. We are concerned about them because they could pose a threat to the existing strong base of ethical standards.
- 1.8** Although we report findings from interviews with public servants, it clearly would be unfair to place the responsibility for maintaining ethical standards solely on the shoulders of public servants. Leadership by members of Parliament, ministers, and deputy ministers is critical to maintaining ethical standards and performance in government. Maintaining ethics in government also is the responsibility of those who supply goods and services to government or receive benefits from government. It is for these reasons that we propose an ethical framework to maintain and promote ethics in government.



Environment Canada: Managing the Legacy of Hazardous Wastes

Assistant Auditor General: Robert R. Lalonde

Responsible Auditors: Wayne Cluskey and Cameron Young

Chapter 2 – Main Points

- 2.1** In 1989, the Canadian Council of Ministers of the Environment approved \$250 million in funding for the National Contaminated Sites Remediation Program to develop technology and clean up contaminated sites. When funding for this joint federal-provincial program ended on 31 March 1995, no national plan or federal fund had been created for cleaning up the remaining contaminated sites that pose risks to human health and the environment.
- 2.2** Comprehensive and consistent information on the number and characteristics of contaminated sites in Canada is not available. This information is essential for estimating clean-up costs and planning action on high-risk sites.
- 2.3** As of 31 March 1995, only 11 of 48 high-risk contaminated sites identified for remediation under the National Contaminated Sites Remediation Program had been fully remediated under federal-provincial agreements. In 1995–96, Environment Canada plans to continue the clean-up of up to 13 of the remaining 37 sites, which are in various stages of remediation. Several sites still pose risks to human health and the environment.
- 2.4** The Department has not proposed amendments to the *Canadian Environmental Protection Act* (1988) or developed regulations under the Act that could help ensure adequate control of environmental risks associated with federal facilities and lands, including the clean-up of federal contaminated sites. However, it has provided an analysis of the issues and options available to the House of Commons Standing Committee on Environment and Sustainable Development, which is currently reviewing the Act.
- 2.5** The Department did not meet a requirement to report to Cabinet by late 1992 on the clean-up of federal sites and the adequacy of funds for this purpose. Preliminary studies indicate that the clean-up will probably cost at least \$2 billion, but better information is needed on the number and characteristics of sites. In addition, none of the potential liabilities have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada.
- 2.6** Furthermore, the Department has not provided Parliament with adequate information through its Part IIIs of the Estimates on actual costs incurred by the National Contaminated Sites Remediation Program, on Program results, on significant constraints to achievement of Program objectives, or on Program funds used for other purposes. However, the Department has made a significant contribution to annual reports on the Program by the Canadian Council of Ministers of the Environment.
- 2.7** The use of polychlorinated biphenyls (PCBs) and the storage and destruction of federal PCB wastes are controlled under the regulations of the *Canadian Environmental Protection Act* to minimize risks to human health and the environment. In 1990, the Green Plan called for destruction of all federal PCBs by 1996. However, the federal PCB Destruction Program, which had been in effect since 1988, ended on 31 March 1995. Moreover, lack of public approval is delaying the process of siting destruction facilities, and equipment containing PCBs remains in service. Therefore, the risks of accidents and the costs of storage will continue into 1996 and beyond.

Chapter 2 – Main Points (cont'd)

2.8 On 31 March 1995, Environment Canada terminated its leadership role in the management of PCB destruction, without devising a plan to guide federal departments to further consolidate PCB wastes, reduce their volume and develop action plans for their destruction. This could seriously impede the government's ability to ensure safe and cost-effective storage and timely destruction of federal PCB wastes.



Federal Radioactive Waste Management

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ellen Shillabeer

Chapter 3 – Main Points

- 3.1** The federal government has a significant role in developing overall policy and federal strategy for radioactive waste management. It has jurisdiction over, and regulatory responsibility for, nuclear energy, including radioactive waste. The government also conducts research on radioactive waste and is an owner of some of this waste.
- 3.2** Radioactive waste management involves the handling and treating of radioactive waste, as well as its transportation, storage and disposal. Storage involves managing radioactive material in a safe manner with provision for retrieval. Disposal refers to permanent placement of radioactive waste with no intention of retrieval.
- 3.3** Federal regulatory policy states that the objectives of radioactive waste disposal are to minimize any burden placed on future generations, to protect the environment and to protect human health. Radioactive waste is generally managed in facilities licensed by the Atomic Energy Control Board (AECB), which provides assurance that the waste is stored in a safe manner. The AECB considers that the current management of the waste is only an interim measure and that long-term solutions are required to ensure long-term safety. Canada has no disposal facilities for any of its high-level or low-level radioactive waste.
- 3.4** Since the early 1950s, Atomic Energy of Canada Limited (AECL) has carried out research on the disposal of high-level radioactive waste, primarily used fuel from nuclear reactors. A major research and development program was initiated in 1978 to find a solution for disposal of this waste. Throughout the program, Canada's target dates for having an operational disposal facility have continually been extended, with 2025 being the current target date for such a facility. Moreover, Canada's program has not kept pace with some other countries. For example, Sweden, which is developing a similar concept, plans to have an operating repository by 2008. Decisions still have to be taken in Canada on whether and how to proceed to a disposal solution. Despite the significant investment, in Canada, of about \$538 million in research and development, there has been no consideration of alternative approaches for moving Canada's high-level radioactive waste program forward after March 1997, when current federal funding ends.
- 3.5** Low-level radioactive waste from ongoing operations of the Canadian nuclear industry is currently stored in AECB-licensed facilities, but a plan needs to be developed for its disposal. Unlike some other countries, Canada does not have an approved disposal technology or any disposal sites or facilities for this operational waste.
- 3.6** Historic wastes are another type of low-level radioactive waste. They are the responsibility of the federal government and are currently being monitored and managed as an interim measure to protect public health and the environment. Various federal initiatives have been undertaken to find long-term solutions. In particular, once the current Siting Task Force presents its report, decisions will be required by the government on implementing long-term solutions for the Port Hope area historic wastes.
- 3.7** Uranium tailings, another class of radioactive waste, fall under federal and provincial regulations. The AECB chose not to license uranium mines that had ceased operations prior to 1976. As a result, these pre-1976 sites have not been subjected to the AECB's current regulatory regime and need to be brought under its regulatory control. The federal and provincial governments need to assign residual responsibilities for the rehabilitation and decommissioning of uranium tailings sites in Ontario and Saskatchewan and for the provision of their long-term institutional care.

Chapter 3 – Main Points (cont'd)

3.8 The federal share, over the next 70 years, for implementation of disposal solutions for Canada's radioactive waste is approximately \$850 million of the at least \$10 billion that is the responsibility of Canadian waste producers, in particular the nuclear utilities. The federal share will increase if the government has to assume residual responsibilities for any of the waste producers. To date, none of the potential liabilities have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada.

3.9 To minimize future federal liabilities and the burden on future generations, Canada must now translate its technical knowledge into implementation of long-term, cost-effective solutions for its radioactive waste. It is also important to ensure that funding arrangements are in place to meet the financial requirements of future solutions. The federal government has an important role to play in making the transition to long-term solutions for used fuel and low-level radioactive waste. In addition to providing policy direction, Natural Resources Canada should work toward establishing an agreement among the major stakeholders on their respective roles and responsibilities and the approaches and plans for implementing solutions.



Health Canada: Management of the Change Initiative at Health Protection Branch

Assistant Auditor General: Maria Barrados

Responsible Auditor: Dan Rubenstein

Chapter 4 – Main Points

4.1 The Health Protection Branch (HPB) of Health Canada is mandated to carry out programs to assess and manage the public health risks faced by Canadians. It plays a unique national role in protecting Canadians against current and emerging public health risks.

4.2 Managers of the Branch were concerned that they could not continue to cut their budgets and, at the same time, meet their obligations to Canadians to manage current and new public health risks. In 1993, the Branch turned to a program of change management to help resolve this dilemma.

4.3 This chapter examines the early progress made by the Branch in bringing about change to deal with the dilemma facing it, as well as to fix some known program problems. We examined the initiative early in the change process to determine whether the Branch's experience could be of help to others facing the same pressures.

4.4 The Branch successfully marshalled the necessary resources to get the process under way. A reasonable initial process was developed and a vision of what was to be achieved was set out. A plan of action called the New Enterprise began implementation in April 1994.

4.5 The process resulted in a number of early achievements such as organizational changes, development of Branch policy and improvement to internal systems.

4.6 Some compromises were made early in the process. Necessary data on the effectiveness and related costs of programs and activities were not always available. Early attempts at developing an approach to the management of public health risks did not produce a useful result that clearly distinguished various public health risks. These areas need attention for the New Enterprise to move forward.

4.7 In areas of continued focus and attention, such as cost recovery, progress continues to be made. Targets have been set and increased revenue is being generated. The speed with which the Branch can reach its targets is strongly influenced by approval processes outside the Branch's control.

4.8 After the first early achievements, the momentum for change throughout the Branch slowed. Pressure had been kept on managers to change through regular review and scrutiny by an oversight committee. The Branch needs to explore ways of rekindling some of this early pressure and enthusiasm.

4.9 At this early phase of the change process, we found slow progress in fixing a number of known program problems. For example, while some action has occurred in the Drugs Directorate, key issues identified in past studies still remain outstanding. Similarly, for the Medical Devices Bureau, many of the changes recommended in 1992 are still not fully implemented. Success in making changes in programming will require sustained effort to solve these problems.

4.10 The experience of HPB points to the importance of managers being proactive. Government managers face many demands from inside and outside their organization for change in programming and budget requirements. By having initiated their own review process, managers in HPB were better positioned to meet the requirements of the government-wide program review and still be in a position to deal with Branch priorities. This ability to respond became even more important with the demands for continuous change and adjustment.

Chapter 4 – Main Points (cont'd)

4.11 The speed with which managers at the Branch can change their programs and activities is tied to the demands of approval processes outside the Branch, such as regulatory approval and authority for cost recovery. The challenge for government will be to find ways to accommodate government-wide requirements, while supporting initiatives in smaller units of government such as the Health Protection Branch.



Assistant Auditor General: Ron Thompson
Responsible Auditor: Beant Barewal

Office of the Superintendent of Financial Institutions

Deposit-taking Institutions Sector

Chapter 5 – Main Points

5.1 The financial services industry has undergone significant change in recent years. Some members have remained strong; several others faced significant difficulties and some did not survive. How well has the Office of the Superintendent of Financial Institutions (OSFI), and the regulatory system overall, done at ensuring the safety and soundness of deposit-taking institutions while meeting the government's objectives? We did not find a satisfactory answer to this question. Although the February, 1995 White Paper deals with several of the related issues, a comprehensive evaluation of the system's effectiveness is required.

5.2 There are certain structural weaknesses in the regulatory system. OSFI's mandate is not stated in one statute. The responsibilities of OSFI, the Canada Deposit Insurance Corporation (CDIC) and the Department of Finance for public policy objectives such as stability and competitiveness of the financial system are unclear. And the Department of Finance has not set out in clear terms how it ensures proper functioning of the regulatory system.

5.3 Accountabilities of the key players in the federal regulatory system are not defined well enough for them to measure and report on their performance. Regulatory processes need to be more transparent and OSFI needs to disclose, to the extent possible, more information about its handling of financial institutions. It should also consider providing to institutions information on best practices in the industry and peer group comparisons.

5.4 OSFI and CDIC responsibilities overlap in several areas. While some overlaps may provide useful checks and balances, others that are judged to be counterproductive should be either eliminated or managed better. Both organizations are making serious efforts to improve co-ordination.

5.5 OSFI must ensure that it is equipped to handle the challenges of the future, as the financial services industry continues its rapid evolution. In particular, OSFI needs to shift some of its emphasis from annual examinations to periodic monitoring of institutions, as their circumstances can change rapidly in this dynamic industry. OSFI should also clarify its expectations in respect of corporate governance in financial institutions and give ongoing attention to studying areas of system-wide risk, such as financial conglomerates and securities activities.

5.6 OSFI's supervisory processes have improved over time, but further significant work needs to be done. For dealing with troubled institutions, OSFI needs to strengthen its processes used to support the exercise of discretionary powers and the development of comprehensive action plans to ensure that remedial measures are taken promptly. In addition, specialized risk areas should be examined in more depth; examination methodology is still developing; post-examination quality control reviews and post-mortem analysis need to be upgraded; and further attention needs to be given to strengthening skills, training and experience of the examination staff.

5.7 OSFI has several important opportunities to achieve organizational efficiencies. Its examination, monitoring and policy functions remain largely separate and distinct between the deposit-taking institutions sector and the insurance sector, while there is increasing integration of these sectors in the financial services industry.



Assistant Auditor General: Shahid Minto
Responsible Auditor: Hugh A. McRoberts

Federal Transportation Subsidies

The Western Grain Transportation Act Program

The Atlantic Region Freight Assistance Program

Chapter 6 – Main Points

6.1 On 27 February 1995, near the end of our audit of the *Western Grain Transportation Act* Program and the Atlantic Region Freight Assistance Program, the government announced the termination of both programs effective 1 August and 1 July respectively. Notwithstanding, we decided to proceed with the presentation of certain of our observations for several reasons: some will assist Parliament in its deliberations on these programs, some will assist in accountability, and some point to matters that will need attention in the wind-up or transition phases of these programs.

6.2 In presenting our findings on these two programs in a single volume, there is a risk that the reader might be led to make comparisons between the two programs. However, each program is unique, with different acts and objectives, and they presented their respective managements with very different sets of challenges. In some circumstances, what was easy for one was difficult for the other due to the wide differences in the design and history of the programs.

The Western Grain Transportation Act Program

6.3 The *Western Grain Transportation Act* (WGTA) was passed in 1983 to facilitate the transportation and handling of Western grain. We examined the roles of the Grain Transportation Agency (GTA) and the National Transportation Agency (NTA) in the program.

6.4 The Grain Transportation Agency has responded to the recommendations that we made in 1987 with respect to the preparation of the grain forecast. However, it has not fulfilled the requirements in the Act for monitoring the performance of the railways and others involved in the grain transportation and handling system.

6.5 Because the rate for grain transportation by rail will continue to be regulated during the transition period for the program (until 2000), the issues of grain hopper car allocation, demand peaking, and the efficient use of the grain hopper car fleet will continue to need attention. We discuss these issues briefly and make recommendations to the Department of Transport, which will be responsible for managing these matters when the Grain Transportation Agency is abolished.

6.6 We observed that the National Transportation Agency had appropriate controls in place for the *Western Grain Transportation Act* payments to the railways.

6.7 The Act requires the National Transportation Agency to conduct an annual review of railway investment plans and a quadrennial review of the railways' costs for grain transportation. Both reviews require the Agency, among other things, to assess investments and costs with respect to their contribution to "an adequate, reliable and efficient" rail transportation system for Western grain. In both cases, the Agency has informed us that it carried out the required assessment on a qualitative basis; in both cases, the documentation of this aspect of the Agency's work did not allow us to determine whether or not the Agency's conclusions were correct.

6.8 At the end of the transition period, the government has mandated that two program reviews will be done: one by industry in 1998, and the other by the government in 1999. The Department of Transport and the National Transportation Agency must begin planning and gathering data now to ensure that the necessary information to carry out these reviews will be available.

Chapter 6 – Main Points (cont'd)

The Atlantic Region Freight Assistance Program

6.9 The Department of Transport has prepared a study titled *Atlantic Region Freight Assistance Program, Information Paper* to measure the effects of the program. We reviewed the *Information Paper* and found it to be, within the limitations of the state of the art for such studies, sound and reliable.

6.10 In the Intra-regional subprogram, the courts have taken a narrow interpretation of the regulations on assessing the eligibility of movements involving non-arm's length shippers and carriers. The Agency recommended changes to the regulations, but no action was taken.

6.11 Deregulation of freight rates in the late 1980s has resulted in a growth in the number of shippers and carriers operating at less than arm's length. Because the rates charged by these carriers are not subject to the discipline of the market place, there is a danger that they may be inflated to attract larger subsidies.

6.12 The cumulative effect of the growth in rate deregulation and in the number of non-arm's length shipper-carriers was that the program's structure, which was designed for another era, was increasingly ill suited to the state of the industry it was subsidizing.

6.13 The Agency does not assess the reasonableness of the freight charges submitted to it for subsidy. It believes that it does not have the authority to do so.

6.14 It will be important to ensure that controls over subsidy payments are rigorously enforced during the program wind-up period.



Travel and Hospitality

Assistant Auditor General: David H. Roth

Responsible Auditor: Trevor R. Shaw

Chapter 7 – Main Points

7.1 Travel is needed to deliver government programs. Travel is expensive by nature. Travel expenditures were \$685 million in 1993-94, in addition to the value of the time of public servants when travelling and to the cost of travel administration. Overall, we found that the management and accountability for travel can be improved.

7.2 Our audit confirmed that there is a low risk of widespread non-compliance with rules governing travel entitlements. Although data are available at the responsibility centre level, information is not organized for senior management to efficiently assess the need for and costs of travel in relation to program benefits. Travel is administered through a system of entitlements. A rule-based system has advantages. However, more emphasis on a values-driven system may lead to more cost-effective travel and better employee morale.

7.3 For the majority of air travel, public servants use economy class. During 1993-94, the Government Travel Service booked more than 230,000 tickets for air travel. Of these, over 93 percent were economy class and less than 7 percent were first class and business class.

7.4 Departments are working to reduce travel costs. Purchasing discounted economy-class tickets through the Government Travel Service saved the government \$37.7 million during 1993-94. Opportunities for further savings include greater use of technology to replace travel, arranging direct discounts for air travel, and extended use of charter air services. Automation and streamlined procedures have the potential for improving control and reducing the cost of travel administration. Pursuit of these opportunities will require focussed effort and co-operation among central agencies and departments.

7.5 Hospitality spending of all departments is not significant in total. Half the spending is concentrated in two departments: Foreign Affairs and International Trade, and National Defence.



Travel Under Foreign Service Directives

Assistant Auditors General: Richard B. Fadden and David H. Roth

Responsible Auditor: Trevor R. Shaw

Chapter 8 – Main Points

8.1 In our 1994 Report, we stated that the Department of Foreign Affairs and International Trade had investigated irregular travel claims submitted by employees under foreign service directives. Further, we indicated that we would follow up on the actions taken by the Department to rectify this problem and would report our findings in May 1995. Travel irregularities were first detected in 1988. A lengthy investigation was begun almost immediately and concluded in September 1994. The final disciplinary actions will be taken during 1995.

8.2 The investigation of travel irregularities by the Department was thorough and identified amounts were recovered. The disciplinary process was well managed and penalties were given for misconduct, mostly in the form of suspensions. This page in the Department's history can now be turned. It is more important to concentrate on the present and the future.

8.3 The Department must continue to work to improve its management of travel. Accountability for the results of foreign service directives needs further clarification by Treasury Board Secretariat in collaboration with affected departments. Decision making by the Department and the Treasury Board Secretariat could be supported by better analytical information.

8.4 In our 1994 Report, we observed that foreign service directives remained complex, and our long-standing concern about this has not been fully resolved. This chapter further illustrates that problem. Changes that were made in 1993 to foreign service directives have provided increased flexibility to employees in the use of travel allowances. The results of these changes, including cost savings, have yet to be assessed. The upcoming triennial review in 1996 should be used as an opportunity to do that. As reported in 1994, the need for a fundamental re-examination of the foreign service directives system remains as the larger challenge.

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Les déplacements

Les déplacements aux termes des directives sur le service extérieur

Vérificateurs généraux adjoints : Richard B. Fadden et David H. Roth
Vérificateur responsable : Trevor R. Shaw



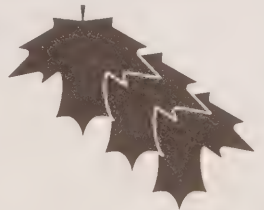
Chapitre 8 – Points saillants

8.1 Dans notre rapport annuel de 1994, nous avons signalé que le ministère des Affaires étrangères et du Commerce international avait fait enquête sur des demandes de remboursements irrégulières que des employés avaient soumises aux termes des directives sur le service extérieur. En outre, nous avons exprimé notre intention de faire un suivi des mesures prises par le Ministère pour rectifier le problème. Nous nous sommes aussi engagés à présenter un rapport de nos constatations en mai 1995. Les premières irrégularités repérées au titre des dépenses de voyage remontent à 1988. Une longue enquête a débuté presque immédiatement et s'est terminée en septembre 1994. Les dernières mesures disciplinaires seront appliquées en 1995.

8.2 L'enquête menée par le Ministère sur les irrégularités relatives aux dépenses de voyage a été approfondie et les sommes relevées ont été recouvrées. Le Ministère a bien su gérer le processus disciplinaire et a imposé des sanctions dans les cas d'inconduite, principalement sous forme de suspensions. On peut maintenant tourner la page et se concentrer sur le présent et l'avenir.

8.3 Le Ministère doit poursuivre ses efforts en vue d'améliorer sa gestion des déplacements. Le Secrétariat du Conseil du Trésor, en collaboration avec les ministères concernés, doit préciser davantage les obligations redditionnelles à l'égard des résultats des directives sur le service extérieur. En outre, le processus de prise de décisions du Ministère et du Secrétariat du Conseil du Trésor à cet égard doit s'appuyer sur une meilleure information analytique.

8.4 Dans notre rapport de 1994, nous observons que les directives sur le service extérieur demeurent très complexes. Il faut dire que, malgré nos fréquentes remarques formulées à ce sujet au fil des ans, nos préoccupations face à cette complexité ne se sont pas complètement dissipées. Dans le présent chapitre, nous nous pencherons à nouveau sur ce problème. Les modifications apportées en 1993 aux directives sur le service extérieur donnent plus de latitude aux employés pour ce qui est d'utiliser leurs allocations de déplacement. Les résultats de ces modifications, y compris les économies réalisées éventuellement, n'ont pas été évalués. Il faudrait saisir cette occasion qu'est l'examen triennal prévu en 1996 pour les vérifier. Comme nous l'avons observé en 1994, une révision en profondeur de tout le système des directives du service extérieur demeure le plus grand défi que doit relever le Ministère.



Vérificateur général adjoint : David H. Roth
Vérificateur responsable : Trevor R. Shaw

Chapitre 7 – Points saillants

7.1 Les déplacements sont nécessaires à l'exécution des programmes du gouvernement. De par leur nature, les déplacements coûtent cher. En 1993-1994, les dépenses de déplacements se sont élevées à 685 millions de dollars; ce montant n'inclut pas la valeur du temps que les fonctionnaires y consacrent ni le coût d'administration de ces déplacements. Dans l'ensemble, nous avons constaté que la gestion et la reddition des comptes pourraient être améliorées.

7.2 Notre vérification a confirmé qu'il existe un faible risque de non-conformité répandue aux règles régissant les indemnités de déplacement. Bien que des données soient disponibles au niveau des centres de responsabilité, l'information n'est pas structurée de façon telle que la direction puisse évaluer avec efficacité la nécessité et les coûts des déplacements par rapport aux avantages de ces derniers pour le programme. Les déplacements sont administrés au moyen d'un système d'indemnités. Un système axé sur les règles comporte des avantages. Toutefois, un système qui accorderait plus d'importance aux valeurs pourrait améliorer le rapport coût-efficacité des déplacements et remonter le moral des employés.

7.3 Pour la majorité de leurs déplacements par avion, les fonctionnaires voyagent en classe économique. En 1993-1994, le Service des voyages du gouvernement a réservé plus de 230 000 billets d'avion. De ce nombre, plus de 93 p. 100 étaient des billets de classe économique et moins de 7 p. 100, des billets de première classe ou de classe affaires.

7.4 Les ministères s'efforcent de réduire les coûts de déplacement. En achetant des sièges de classe économique à tarif réduit, le Service des voyages du gouvernement a permis au gouvernement d'économiser 37,7 millions de dollars en 1993-1994. Parmi les mesures qui pourraient se solder par des économies, mentionnons le recours accru à la technologie pour remplacer des déplacements, l'obtention de rabais directs sur les billets d'avion et l'utilisation accrue des vols noyés. L'automatisation et la rationalisation des procédures pourraient permettre d'améliorer le contrôle et de réduire les coûts de l'administration des déplacements. La mise en oeuvre de ces stratégies exigera des efforts concertés et la collaboration entre organismes centraux et ministères.

7.5 Les frais d'accueil de tous les ministères ne représentent pas au total une somme importante. La moitié des frais sont engagés par deux ministères : le ministère des Affaires étrangères et du Commerce international et le ministère de la Défense nationale.

Chapitre 6 – Points saillants (suite)

6.8 Le gouvernement a ordonné que deux examens de programme soient faits à la fin de la période de transition, l'un par l'industrie en 1998, et l'autre par le gouvernement en 1999. Le ministère des Transports et l'Office national des transports doivent commencer maintenant la planification et la collecte de données pour que soient disponibles les renseignements nécessaires à ces examens.

Le Programme de subventions au transport des marchandises dans la Région atlantique

6.9 Le ministère des Transports a produit une étude intitulée *Programme de subventions au transport des marchandises dans la Région atlantique, Cahier d'information* pour mesurer les effets de ce programme. Nous avons examiné ce cahier et l'avons jugé fiable, compte tenu des limites inhérentes à l'évolution des connaissances pour les études de ce genre.

6.10 En ce qui concerne le sous-programme des subventions au transport intrarégional, les tribunaux ont adopté une interprétation étroite des dispositions réglementaires pour déterminer l'admissibilité des mouvements où interviennent des expéditeurs et des transporteurs avec lien de dépendance. L'Office a recommandé une modification de la réglementation, mais on n'y a pas donné suite.

6.11 La déréglementation des taux de transport des marchandises survenue à la fin des années 80 a entraîné une multiplication des expéditeurs et transporteurs avec lien de dépendance. Comme les taux demandés par ces derniers ne sont pas soumis aux forces du marché, il y a risque qu'ils soient gonflés pour que l'on puisse toucher des subventions plus élevées.

6.12 La multiplication des transporteurs et des expéditeurs avec lien de dépendance et la déréglementation des taux de transport qui s'est accentuée ont eu pour effet de rendre le Programme, conçu pour une autre époque, de moins en moins adapté à l'état de l'industrie qu'il visait à subventionner.

6.13 L'Office n'évalue pas le caractère raisonnable des frais de transport des marchandises qui lui sont soumis aux fins du versement de subventions. Il estime ne pas avoir l'autorité pour ce faire.

6.14 Il importera de veiller à l'application rigoureuse des mesures de contrôle sur le versement des subventions durant la période de dissolution du Programme.

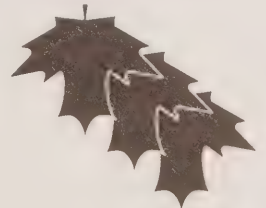
- 6.7 La Loi oblige l'Office national des transports à procéder à un examen annuel des plans d'investissement des chemins de fer et à un examen quadriennal des coûts que ces derniers ont absorbés pour le transport du grain. Dans les deux examens, l'Office doit, entre autres, évaluer la contribution des investissements et des coûts au maintien d'un réseau de transport ferroviaire « adéquat, fiable et efficace » pour le grain de l'Ouest. Dans les deux cas, l'Office nous a informés qu'il effectuait l'évaluation requise en termes qualitatifs. La documentation de cet aspect de son travail ne nous a permis, dans aucun de ces cas, de déterminer l'exactitude de ses conclusions.
- 6.6 Nous avons constaté que l'Office national des transports avait établi des mesures de contrôle appropriées pour les paiements à verser aux chemins de fer en application de la Loi sur le transport du grain de l'Ouest.
- 6.5 Comme on continuera de réglementer le taux de transport du grain par chemin de fer pendant la période de transition (jusqu'en l'an 2000), il faudra continuer de prêter attention aux questions de la répartition des wagons-trémies, de la demande de pointe et de l'utilisation efficace de ces wagons. Nous allons en traiter brièvement et faire des recommandations au ministre des Transports, qui en sera chargé après la dissolution de l'Office du transport du grain.
- 6.4 L'Office du transport du grain a donné suite à nos recommandations de 1987 au sujet des prévisions du volume de grain. Toutefois, il n'a pas satisfait aux exigences de la Loi en ce qui concerne la surveillance du rendement des chemins de fer et des autres participants au transport et à la manutention du grain.
- 6.3 La Loi sur le transport du grain de l'Ouest (LTGO) a été adoptée en 1983 pour faciliter le transport et la manutention du grain de l'Ouest. Nous avons examiné les rôles que l'Office du transport du grain (OTG) et l'Office national des transports (ONT) jouaient dans le programme qui en a résulté.

Le Programme de la Loi sur le transport du grain de l'Ouest

- 6.2 L'exposé de nos constatations sur ces deux programmes dans un même volume risque d'amener le lecteur à faire des comparaisons entre les deux. Cependant, ce sont là des programmes uniques, régis par des lois et des objectifs distincts. Ils ont présenté des défis très différents à leurs directions respectives; dans certains cas, ce qui était facile pour l'une a été difficile pour l'autre en raison de leur conception et de leur contexte historique très différents.
- 6.1 Le 27 février 1995, vers la fin de notre vérification du Programme de la Loi sur le transport du grain de l'Ouest et du Programme de subventions au transport des marchandises dans la Région atlantique, le gouvernement a annoncé que ces programmes seraient abolis le 1^{er} août et le 1^{er} juillet respectivement. Nous avons quand même décidé de communiquer certaines de nos observations pour plusieurs raisons : certaines aideront le Parlement à débiter sur ces programmes, d'autres aideront à la reddition des comptes, et d'autres encore portent sur des questions auxquelles il faudra prêter attention pendant les phases de transition ou de dissolution de ces programmes.
- 6.1 Le 27 février 1995, vers la fin de notre vérification du Programme de la Loi sur le transport du grain de l'Ouest et du Programme de subventions au transport des marchandises dans la Région atlantique, le

Chapitre 6 – Points saillants

Vérificateur général adjoint : Shahid Minto
Vérificateur responsable : Hugh A. McRoberts



Les subventions fédérales au transport

Le Programme de la Loi sur le transport du

grain de l'Ouest

Le Programme de subventions au transport

des marchandises dans la Région atlantique

5.6 Les processus de surveillance du BSIF ont été améliorés graduellement, mais il reste encore beaucoup à faire. Pour s'occuper des institutions en difficulté, le BSIF doit renforcer les processus qu'il utilise pour appuyer l'exercice de ses pouvoirs discrétionnaires et l'élaboration de plans d'action exhaustifs, afin de s'assurer que des mesures correctives sont prises rapidement. De plus, les secteurs spécialisés à risques devraient faire l'objet d'une inspection plus approfondie; l'élaboration des méthodes d'inspection n'est pas encore terminée; les examens du contrôle de la qualité postérieurs à l'inspection et l'analyse rétrospective (post mortem) doivent être améliorés; et il faut accorder plus d'attention à l'amélioration des compétences, de la formation professionnelle et de l'expérience des inspecteurs.

5.7 Le BSIF a plusieurs occasions importantes de réaliser des efficacités sur le plan organisationnel. Ses fonctions d'inspection, de surveillance et d'élaboration des politiques, pour le secteur des institutions de dépôt et celui des assurances, demeurent en grande partie séparées et distinctes alors que ces secteurs sont de plus en plus intégrés dans l'industrie des services financiers.

Bureau du surintendant des institutions financières

Secteur des institutions de dépôt

Vérificateur général adjoint : Ron Thompson
Vérificateur responsable : Beant Barewal



Chapitre 5 – Points saillants

5.1 L'industrie des services financiers a subi d'importantes transformations ces dernières années. Certains membres sont demeurés en bonne santé financière; plusieurs autres ont été confrontés à des problèmes importants et certains n'ont pas survécu. Dans quelle mesure le Bureau du surintendant des institutions financières (BSIF) et le système de réglementation dans son ensemble ont-ils permis d'assurer la sécurité et la santé financière des institutions de dépôt, tout en permettant d'atteindre les objectifs établis par le gouvernement? Nous n'avons pas trouvé de réponse satisfaisante à cette question. Même si le Livre blanc publié en février 1995 traite de plusieurs questions connexes, une évaluation exhaustive de l'efficacité du système s'impose.

5.2 Le système de réglementation comporte certaines faiblesses structurelles. Le mandat du BSIF n'est pas établi dans une seule loi. Les responsabilités du BSIF, de la Société d'assurance-dépôts du Canada (SADC) et du ministère des Finances, en ce qui concerne les objectifs de politique publique comme la stabilité et la compétitivité du système financier, ne sont pas claires. Et le ministère des Finances n'a pas précisé de quelle façon il assure le fonctionnement harmonieux du système de réglementation.

5.3 Les responsabilités des principaux intervenants dans le système de réglementation fédéral ne sont pas assez bien définies pour leur permettre de mesurer les résultats obtenus et d'en faire rapport. Les processus de réglementation doivent être plus transparents et le BSIF doit, dans la mesure du possible, divulguer plus de renseignements au sujet de la façon dont il supervise les institutions financières. Il devrait aussi envisager la possibilité de fournir aux institutions des renseignements sur les meilleures pratiques de gestion dans l'industrie et des comparaisons avec des groupes de pairs.

5.4 Les responsabilités du BSIF et de la SADC se chevauchent dans plusieurs domaines. Même si certains chevauchements peuvent servir de mécanismes utiles d'autocoût, d'autres, qui semblent aller à l'encontre des buts recherchés, devraient être éliminés ou mieux gérés. Les deux organismes s'efforcent sérieusement d'améliorer leur coordination.

5.5 Le BSIF doit s'assurer qu'il a les moyens de relever les défis qui se posent à l'avenir, car l'industrie des services financiers continue d'évoluer rapidement. En particulier, le BSIF doit donner l'accent à la surveillance périodique des institutions plutôt qu'à l'inspection annuelle, car la situation peut évoluer rapidement dans cette industrie dynamique. Le BSIF devrait aussi préciser ses attentes en matière de régulation interne dans les institutions financières et accorder une attention de tous les instants à l'étude des secteurs qui posent des risques systémiques, comme les conglomérats financiers et les activités relatives aux valeurs mobilières.

- 4.9** À ce stade précoce du processus de changement, nous avons constaté que le règlement d'un certain nombre de problèmes déjà connus progressait assez lentement. Par exemple, bien que la Direction des médicaments ait pris certaines mesures, d'importants problèmes soulevés au cours d'études précédentes ne sont toujours pas réglés. De même, au Bureau des matériels médicaux, un bon nombre des changements recommandés en 1992 n'ont pas encore été entièrement apportés. Pour que les changements dans les programmes portent fruit, il faudra consacrer des efforts soutenus afin de résoudre ces problèmes.
- 4.10** L'expérience de la DGPS indique à quel point il est important que les gestionnaires soient proactifs. Les gestionnaires du gouvernement font face à de nombreuses demandes de changement dans les programmes et dans les budgets, provenant soit de l'intérieur, soit de l'extérieur de leurs organisations. En mettant en route leur propre processus d'examen, les gestionnaires de la DGPS étaient en meilleure position pour satisfaire à la fois aux exigences de l'examen des programmes du gouvernement et aux priorités de la Direction générale. La nécessité permanente de changer et de s'ajuster rend cette capacité de réaction d'autant plus importante.
- 4.11** La rapidité avec laquelle les gestionnaires de la Direction générale peuvent modifier leurs programmes et leurs activités est liée aux exigences de processus d'approbation extérieurs à la Direction générale, comme l'approbation réglementaire et les autorisations pour le recouvrement des coûts. Le défi du gouvernement sera de trouver des manières de satisfaire aux exigences qui s'appliquent à toute l'administration fédérale, tout en appuyant les initiatives prises par de plus petites unités comme la Direction générale de la protection de la santé.



Chapitre 4 – Points saillants

4.1 La Direction générale de la protection de la santé (DGPS) de Santé Canada a pour mandat d'exécuter des programmes d'évaluation et de gestion des risques pour la santé publique auxquels sont exposés les Canadiens. La Direction générale joue un rôle national unique en ce sens qu'elle protège les Canadiens des risques, actuels ou nouveaux, pour la santé publique.

4.2 Les gestionnaires de la Direction générale craignaient de n'être plus en mesure de faire face à leurs obligations envers les Canadiens, à savoir gérer les risques, actuels ou nouveaux, pour la santé publique, s'ils continuaient de réduire leurs budgets. En 1993, la Direction générale a fait appel à un programme de gestion du changement pour résoudre ce dilemme.

4.3 Le présent chapitre examine les premiers progrès réalisés par la Direction générale dans l'introduction de changements susceptibles de résoudre le dilemme en question, et de régler certains problèmes de programme connus. Nous avons examiné le projet aux premiers stades du processus afin de déterminer si l'expérience de la Direction générale pourrait être de quelque utilité pour d'autres organismes qui se trouvent soumis à des pressions semblables.

4.4 La Direction générale a réussi à rassembler les ressources nécessaires pour mettre les choses en route. Un processus initial acceptable a été élaboré et une vision de ce que l'on souhaitait réaliser a été définie. La mise en oeuvre d'un plan d'action appelé Nouvelle entreprise a commencé en avril 1994.

4.5 Le processus a, dès le début, abouti à un certain nombre de résultats comme les changements organisationnels, l'élaboration d'un cadre stratégique de la Direction générale et l'amélioration de systèmes internes.

4.6 Il a fallu faire des compromis au début du processus. Les données nécessaires sur l'efficacité et les coûts connexes des programmes et des activités n'étaient pas toujours disponibles. Les premières tentatives d'élaboration d'une stratégie de gestion des risques pour la santé publique n'ont pas produit de résultats qui permettent de distinguer clairement les divers risques pour la santé publique. Ce sont des points dont il faudra s'occuper pour que la Nouvelle entreprise puisse aller de l'avant.

4.7 Dans des domaines auxquels on porte une attention soutenue, comme le recouvrement des coûts, on continue de faire des progrès. Des cibles ont été fixées, et on génère plus de recettes. La rapidité avec laquelle la Direction générale peut atteindre ses cibles est fortement influencée par des processus d'approbation qui échappent à son contrôle.

4.8 Après les premières réalisations, le rythme du changement s'est ralenti dans toute la Direction générale. Des pressions visant à inciter les gestionnaires à faire des changements ont continué de s'exercer grâce aux examens réguliers et minutieux d'un comité de surveillance. La Direction générale doit chercher des manières de retrouver une partie de son élan et de son enthousiasme du début.

3.6 Il existe un autre type de déchets faiblement radioactifs; on les appelle les déchets historiques. Ils relèvent de la compétence du gouvernement fédéral et, à l'heure actuelle, ils sont surveillés et traités dans le cadre d'une mesure provisoire visant à protéger la santé du public et l'environnement. Le gouvernement fédéral a entrepris différentes initiatives en vue de trouver des solutions à long terme. En particulier, lorsque le Groupe de travail chargé du choix d'un site de gestion des déchets faiblement radioactifs présentera son rapport, le gouvernement devra prendre des décisions au sujet de la mise en oeuvre de solutions à long terme pour les déchets radioactifs historiques de la région de Port Hope.

3.7 Les résidus d'uranium, autre catégorie de déchets radioactifs, sont régis par des règlements fédéraux et provinciaux. La CCEA a choisi de ne pas délivrer de permis aux mines d'uranium dont les activités avaient cessé avant 1976. Il s'ensuit que ces sites ne sont pas assujettis au régime de réglementation actuel de la CCEA et qu'ils devraient l'être. Les gouvernements fédéral et provinciaux doivent déterminer à qui reviennent les responsabilités résiduelles pour la remise en état et le déclassement des sites de résidus d'uranium en Ontario et en Saskatchewan, et prévoir des mesures institutionnelles pour l'entretien à long terme de ces sites.

3.8 Au cours des prochaines années, la part du fédéral dans la mise en oeuvre de solutions de stockage permanent des déchets radioactifs du Canada s'élèvera à environ 850 millions de dollars. Cela s'inscrit parmi les 10 milliards de dollars au moins, qui relèvent de la responsabilité des producteurs de déchets, en particulier les services d'électricité qui exploitent des réacteurs nucléaires. La part du fédéral augmentera si le gouvernement doit assumer une responsabilité résiduelle pour d'autres producteurs de déchets. Jusqu'à maintenant, aucun passif éventuel n'a été divulgué dans les Notes afférentes aux états financiers du gouvernement du Canada ni dans les Notes afférentes au *Rapport financier annuel* du gouvernement du Canada.

3.9 Afin de réduire au minimum le passif éventuel du gouvernement fédéral et le fardeau pour les générations futures, les connaissances techniques du Canada doivent maintenant se traduire par la mise en oeuvre de solutions à long terme rentables pour ces déchets radioactifs. Il importe également de voir à ce que des arrangements soient en place pour couvrir les besoins de financement des solutions futures. Le gouvernement fédéral a un rôle important à jouer pour assurer la mise en oeuvre de solutions à long terme concernant le stockage permanent du combustible épuisé et des déchets faiblement radioactifs. En plus de fournir une orientation de principe, Ressources naturelles Canada devra axer son travail sur la conclusion d'une entente entre les principaux intervenants en ce qui a trait à leurs rôles et responsabilités respectifs ainsi qu'aux approches et aux plans pour la mise en oeuvre des solutions.



Vérificatrice générale adjointe : Maria Barrados
Vérificatrice responsable : Ellen Shillabeer

Chapitre 3 – Points saillants

3.1 Le gouvernement fédéral joue un rôle important au niveau de l'élaboration d'une politique d'ensemble et d'une stratégie fédérale en matière de gestion des déchets radioactifs. L'énergie nucléaire, incluant les déchets radioactifs, relève de son champ de compétence et de ses pouvoirs de réglementation. Il effectue également des recherches sur les déchets radioactifs et il est propriétaire d'une partie de ceux-ci.

3.2 La gestion des déchets radioactifs comporte la manutention et le traitement des déchets radioactifs ainsi que leur transport, leur stockage et leur évacuation. Le stockage est une méthode de gestion sûre des matières radioactives, qui permet leur récupération. L'évacuation désigne un confinement permanent des déchets radioactifs, sans intention de récupération.

3.3 La politique de réglementation fédérale indique que les objectifs de l'évacuation des déchets radioactifs sont de réduire au minimum le fardeau des générations futures et de protéger l'environnement et la santé des êtres humains. En général, les déchets radioactifs sont gérés dans des installations qui sont titulaires d'un permis de la Commission de contrôle de l'énergie atomique (CCEA), qui veille à ce que les déchets soient stockés d'une manière sûre. La CCEA considère la gestion actuelle des déchets comme une mesure provisoire, à laquelle il faut trouver des solutions à long terme pour assurer la sécurité à long terme. Le Canada ne possède aucune installation de stockage permanent pour les déchets hautement radioactifs, ni pour les déchets faiblement radioactifs.

3.4 Depuis le début des années 50, l'énergie atomique du Canada Limitée (EACL) a mené des recherches sur l'évacuation des déchets hautement radioactifs, surtout sur le combustible épuisé des réacteurs nucléaires. En 1978, un important programme de recherche et de développement a été entrepris afin de trouver une solution à ce problème. Tout au long du programme, les dates cibles visées par le Canada pour le fonctionnement de l'installation d'évacuation ont constamment été reportées, l'an 2025 étant la date prévue actuellement pour cette installation. De plus, le programme canadien n'a pas avancé aussi rapidement que celui de certains autres pays. Par exemple, la Suède, qui élabore un concept similaire, prévoit avoir une installation de stockage permanent d'ici l'an 2008. Au Canada, des décisions doivent encore être prises pour déterminer s'il faut s'engager dans le domaine de l'évacuation des déchets et comment le faire. Malgré des investissements majeurs d'environ 538 millions de dollars faits au Canada en recherche et développement, on n'a pas envisagé d'approches de rechange pour poursuivre le programme de gestion des déchets hautement radioactifs après mars 1997, soit lorsque le financement actuel du gouvernement prendra fin.

3.5 Les déchets faiblement radioactifs découlant des activités continues de l'industrie nucléaire sont présentement stockés dans des installations titulaires d'un permis de la CCEA, mais il faut élaborer un plan pour le stockage permanent de tous ces déchets. Contrairement à certains autres pays, le Canada n'a approuvé aucune technologie de stockage permanent, ni de site d'évacuation pour ses déchets d'exploitation.

2.7 L'utilisation des biphényles polychlorés (BPC) ainsi que l'entreposage et la destruction des déchets fédéraux contenant des BPC sont contrôlés en vertu des règlements d'application de la Loi canadienne sur la protection de l'environnement afin d'atténuer les risques pour la santé humaine et l'environnement. En 1990, le Plan vert prévoyait la destruction de tous les BPC fédéraux d'ici 1996. Or, le programme fédéral de destruction des BPC, en vigueur depuis 1988, a pris fin le 31 mars 1995. De plus, l'absence d'autorisation publique retarde le processus de choix d'un lieu où aménager les installations de destruction et il y a encore du matériel contenant des BPC en service. Il y aura donc risques d'accident et coûts d'entreposage en 1996 et au-delà.

2.8 Le 31 mars 1995, Environnement Canada a mis fin à son rôle de chef de file en matière de gestion de la destruction des BPC, sans avoir préparé un plan pour aider les ministères fédéraux à regrouper d'avantage leurs déchets contenant des BPC et à en réduire le volume, ainsi qu'à élaborer des plans d'action en vue de leur destruction. Cela pourrait menacer sérieusement la capacité du gouvernement d'assurer un entreposage sûr et rentable de même que la destruction en temps opportun des déchets fédéraux contenant des BPC.



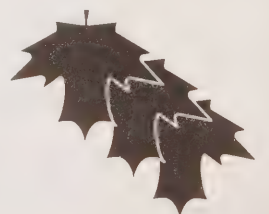
Environnement Canada : Les déchets dangereux — la gestion d'un lourd héritage

Vérificateur général adjoint : Robert R. Lalonde
Vérificateurs responsables : Wayne Cluskey et Cameron Young

Chapitre 2 – Points saillants

- 2.1** En 1989, le Conseil canadien des ministres de l'environnement a approuvé un financement de 250 millions de dollars pour le Programme national d'assainissement des lieux contaminés afin de mettre au point de nouvelles techniques et de dépolluer les lieux contaminés. Lorsque le financement de ce programme fédéral-provincial a pris fin le 31 mars 1995, aucun plan national ni aucun fonds fédéral n'a été créé pour l'assainissement des autres lieux contaminés qui présentent des risques pour la santé humaine et l'environnement.
- 2.2** On ne possède pas d'information complète et cohérente sur le nombre et les caractéristiques des lieux contaminés au Canada. Cette information est essentielle pour évaluer les coûts d'assainissement des lieux à risque élevé et adopter un plan d'action.
- 2.3** Au 31 mars 1995, seulement 11 des 48 lieux contaminés à risque élevé, répertoriés en vue de leur dépollution en vertu du Programme national d'assainissement des lieux contaminés, ont été entièrement dépollués en vertu des ententes fédérales-provinciales. En 1995-1996, Environnement Canada prévoit poursuivre la dépollution de tout au plus 13 des 37 lieux restants qui en sont encore à diverses étapes du processus d'assainissement. Plusieurs de ces lieux présentent encore des risques pour la santé humaine et l'environnement.
- 2.4** Le Ministère n'a pas proposé de modification à la *Loi canadienne sur la protection de l'environnement* (1988) ni élaboré de règlements en vertu de la Loi qui permettraient d'assurer un contrôle adéquat des risques environnementaux associés aux installations et aux terres de l'État, y compris la dépollution des lieux contaminés fédéraux. Il a cependant fourni une analyse des questions et des options disponibles au Comité permanent de l'environnement et du développement durable de la Chambre des communes, qui étudie actuellement la Loi.
- 2.5** Le Ministère n'a pas respecté l'exigence à l'effet qu'il devait rendre compte au Cabinet à la fin de 1992 relativement à la dépollution des lieux fédéraux et à la suffisance des fonds à cet effet. Les études préliminaires indiquent que la dépollution coûtera probablement au moins deux milliards de dollars, mais encore faut-il obtenir de meilleures informations quant au nombre et aux caractéristiques des lieux. De plus, aucune des obligations éventuelles n'a été divulguée dans les Notes afférentes aux états financiers du Canada ni dans les Notes afférentes au *Rapport financier annuel* du gouvernement du Canada.
- 2.6** De plus, le Ministère n'a pas fourni au Parlement l'information adéquate dans la Partie III du *Budget des dépenses* concernant les coûts réels du Programme national d'assainissement des lieux contaminés, ni sur les résultats du Programme ou les contraintes importantes qui ont empêché d'atteindre les objectifs du Programme ni sur les fonds affectés au Programme qui ont été utilisés à d'autres fins. Cependant, le Ministère a contribué de façon importante aux rapports annuels sur le Programme faits par le Conseil canadien des ministres de l'environnement.

La sensibilisation à l'éthique et à la fraude au gouvernement



Vérificateur général adjoint : Richard B. Fadden
Vérificateur responsable : Alan R. Gilmore

Chapitre 1 – Points saillants

1.1 Les Canadiens se préoccupent de l'intégrité du gouvernement et ils ont le droit de s'attendre à ce que l'administration publique respecte les normes d'éthique les plus élevées. Cependant, ils doivent se rendre compte qu'ils ont également plus d'attentes à l'égard des normes d'éthique d'un certain nombre d'autres institutions et professions et que ces dernières, aussi bien que les leurs, influencent les normes du gouvernement.

1.2 Nous n'avons pas entrepris cette étude parce que nous pensions que les normes d'éthique des gouvernements canadiens diminuaient de rigueur ou étaient inférieures à celles du secteur privé. Les Canadiens attendent probablement beaucoup plus du secteur public que du secteur privé pour ce qui est du respect des normes d'éthique.

1.3 Nous n'avons pas non plus entrepris cette étude parce que nous pensions que la situation au Canada était pire que dans les autres pays. À notre avis, les gouvernements canadiens n'ont rien à envier aux administrations des autres pays en fait d'intégrité.

1.4 Et pourtant, les Canadiens se préoccupent de l'intégrité du gouvernement. Si les Canadiens n'ont pas confiance en leurs gouvernements, les actes de ceux-ci seront de moins en moins légitimes et de moins en moins efficaces. De là, toute l'importance d'un débat sur l'éthique au gouvernement et la nécessité de mesures qui permettront de maintenir et d'encourager le respect de l'éthique au sein du gouvernement.

1.5 Le présent chapitre ne vise qu'une partie de la question de l'éthique au sein du gouvernement. L'éthique dans la prise de décisions. L'éthique dans la prise de décisions signifie que les décisions sont prises en toute impartialité et en toute objectivité, et dans l'intérêt public.

1.6 Le chapitre propose un cadre d'éthique qui reconnaît l'importance des mesures gouvernementales existantes et qui tient compte des résultats des entrevues en profondeur que nous avons menées avec des fonctionnaires sur la sensibilisation à l'éthique et à la fraude. La fonction publique étant un bien public, ce cadre doit faire en sorte que ce principe soit la pierre angulaire de l'administration publique canadienne.

1.7 Le chapitre présente également les résultats de nos entrevues avec des fonctionnaires de quatre ministères. Ces résultats indiquent qu'au chapitre des normes d'éthique dans la fonction publique, nous partons d'une base solide. Cependant, nous avons trouvé des secteurs vulnérables. Cela nous préoccupe parce qu'ils pourraient constituer une menace pour la base solide que nous avons actuellement.

1.8 Bien que notre rapport présente des constatations tirées d'entrevues avec des fonctionnaires, il ne serait vraiment pas juste de placer toute la responsabilité du respect des normes d'éthique sur les seuls fonctionnaires. Le leadership des députés, des ministres et des sous-ministres est indispensable pour maintenir les normes d'éthique et le rendement au gouvernement. Le respect de l'éthique au gouvernement incombe aussi à tous ceux qui fournissent des produits et des services au gouvernement ou qui en reçoivent des avantages. C'est pour ces raisons que nous proposons un cadre visant à maintenir et à encourager le respect de l'éthique au gouvernement.

Cette année, nous publierons un autre « rapport supplémentaire » au début de l'automne, et notre rapport annuel, comme d'habitude, à la fin de novembre. Au cours des prochaines années, nous comptons déposer en plus du rapport annuel jusqu'à trois rapports (mais pas nécessairement trois). Mon bureau aura également la responsabilité de préparer le rapport annuel du commissaire à l'environnement, et nous ne savons pas encore quelle incidence cela aura sur notre processus de rapport et nos ressources.

Dans le présent rapport et les rapports qui suivront, les chapitres seront reliés individuellement ou regroupés avec d'autres qui traitent d'un même sujet et qui sont susceptibles d'intéresser les mêmes lecteurs. En 1994, nous avons fait l'expérience des chapitres reliés séparément et nous avons constaté que nos lecteurs les trouvaient plus commodes à utiliser et que la recherche en était facilitée. En outre, cela nous permet de diffuser les chapitres en fonction des besoins précis des lecteurs. Nos rapports continueront d'être accessibles sur support électronique et sur Internet.

Je continuerai de tirer des conclusions générales et d'attirer l'attention sur des questions importantes dans le chapitre de mon rapport annuel intitulé « Questions d'une importance et d'un intérêt particuliers ». En règle générale, le rapport annuel comprendra également les « Autres observations de vérification » et les résultats de nos suivis habituels sur les chapitres de vérification des années antérieures. Cependant, il pourra arriver qu'en raison du sujet ou du moment, il soit utile de publier ces résultats dans un chapitre de vérification sur le ministère en question.

Après le premier cycle annuel de rapports, je consulterai les comités parlementaires et, au besoin, d'autres députés, pour déterminer si le calendrier des rapports est satisfaisant ou s'il y a place à amélioration. Nous examinerons également l'incidence du calendrier sur les activités des ministères.

Nous voulons avant tout servir le Parlement avec promptitude et lui offrir les services les plus appropriés possible. Les modifications apportées à la *Loi sur le vérificateur général* nous ont rapprochés de ce but.



Avant-propos

En juin 1994, la *Loi sur le vérificateur général* a été modifiée pour permettre chaque année le dépôt d'un rapport annuel, de trois rapports supplémentaires au maximum et de rapports spéciaux sur toute affaire importante ou urgente.

Cette modification permet au Bureau du vérificateur général d'améliorer ses services au Parlement. Lorsque le Bureau était restreint à un rapport annuel, les députés avaient parfois à étudier des questions qui étaient déjà désuètes. L'autorisation de déposer jusqu'à trois rapports supplémentaires par an nous permettra de fournir de l'information plus actuelle et plus pertinente sur les résultats de nos travaux.

Puisque le Parlement sera en mesure d'étudier sans tarder les résultats de nos vérifications, des mesures correctives pourront être prises plus rapidement, ce qui pourra se traduire par des économies pour le contribuable. En raison de l'urgence de réduire les déficits et la dette publique, il est important pour le gouvernement et le Parlement d'être en mesure de démontrer qu'ils profitent rapidement des possibilités d'épargne cernées.

Je suis heureux de déposer notre premier « rapport supplémentaire ». Outre l'avant-propos et les points saillants qui suivent, le Rapport comprend huit chapitres :

- La sensibilisation à l'éthique et à la fraude au gouvernement
- Environnement Canada : Les déchets dangereux — la gestion d'un lourd héritage
- La gestion des déchets radioactifs par le gouvernement fédéral
- Santé Canada : La gestion d'un projet de réforme à la Direction générale de la protection de la santé
- Bureau du surintendant des institutions financières — Secteur des institutions de dépôt
- Les subventions fédérales au transport
- Le Programme de la *Loi sur le transport du grain de l'Ouest*
- Le Programme de subventions au transport des marchandises dans la Région atlantique
- Les déplacements et l'accueil
- Les déplacements aux termes des directives sur le service extérieur

Nous nous efforcerons de déposer nos rapports à des dates assez régulières et à des moments où les parlementaires pourront les étudier — c'est-à-dire au moins un mois avant un congé prévu et au plus tard deux semaines après la reprise des travaux de la Chambre. De plus, dans la planification courante de nos vérifications, nous tenterons d'harmoniser nos rapports avec les activités réalisées par les ministères à l'intention du Parlement. Nous voulons ainsi que les ministères soient le plus à même de donner rapidement suite à nos rapports.

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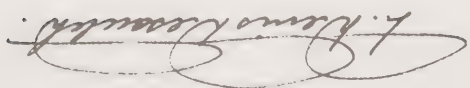
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OTTAWA, le 11 mai 1995

L. Denis Desautels, FCA



Le vérificateur général du Canada,

J'ai l'honneur de vous transmettre ci-joint mon premier rapport de 1995 à la
Chambre des communes, lequel doit être déposé à la Chambre en conformité avec les
dispositions du paragraphe 7(5) de la Loi sur le vérificateur général.

À l'honorable Président de la Chambre des communes :

AUDITOR GENERAL OF CANADA



VÉRIFICATEUR GÉNÉRAL DU CANADA

Le Rapport de mai 1995 comporte 8 chapitres ainsi qu'un Avant-propos et Points saillants. Pour mieux répondre aux besoins de nos clients, il est disponible sur divers supports. Pour obtenir d'autres documents ou les obtenir sur un autre support, voir la Table des matières et le bon de commande à la fin du présent document.

Rapport du
Vérificateur général
du Canada
à la Chambre des communes
Avant-propos et Points saillants

Mai 1995

Rapport du
Vérificateur général
du Canada
à la Chambre des communes
Avant-propos et Points saillants

Mai 1995

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 1
Ethics and Fraud Awareness in Government

May 1995

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Auditor General
of Canada
to the House of Commons**

Chapter 1
Ethics and Fraud Awareness in Government



May 1995

This May 1995 Report comprises 8 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 1

Ethics and Fraud Awareness in Government

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Ethics and Fraud Awareness in Government

Assistant Auditor General: Richard B. Fadden

Responsible Auditor: Alan R. Gilmore

Main Points

1.1 Canadians are concerned about integrity in government and they have the right to expect the highest ethical standards in their governments. However, they also need to appreciate that they have raised similar concerns about the ethical standards of a number of other institutions and occupations and that these ethical standards, as well as their own, influence those in government.

1.2 We did not undertake this study because we believe that ethical standards in Canadian governments are declining or are worse than those in the private sector. The expectations of Canadians for ethical conduct in the public sector are probably greater than for most of the private sector.

1.3 Nor did we undertake this study because we believe that ethical standards in Canadian governments are worse than those of other countries. We believe that Canadian governments compare very favourably with others in their integrity.

1.4 However, Canadians are concerned about integrity in government. If Canadians do not trust their governments to act ethically, governments will find that their actions have less and less legitimacy and effectiveness. Thus, we believe that it is important to discuss ethics in government and to take action to maintain and promote ethics in government.

1.5 The chapter addresses only a part of the subject of ethics in government — ethics in decision making. Ethics in decision making means that decisions are made impartially and objectively, and in the public interest.

1.6 The chapter proposes a framework for ethics in government that recognizes the importance of existing government measures and reflects the results of extensive interviews with public servants about ethics and fraud awareness. The objective of this framework is to help ensure that the principle that public service is a public trust is the cornerstone of Canadian public administration.

1.7 The chapter also reports the results of our interviews with public servants in four departments. The results indicate that we are starting from a strong base of ethical standards among public servants. However, we found some areas of vulnerability. We are concerned about them because they could pose a threat to the existing strong base of ethical standards.

1.8 Although we report findings from interviews with public servants, it clearly would be unfair to place the responsibility for maintaining ethical standards solely on the shoulders of public servants. Leadership by members of Parliament, ministers, and deputy ministers is critical to maintaining ethical standards and performance in government. Maintaining ethics in government also is the responsibility of those who supply goods and services to government or receive benefits from government. It is for these reasons that we propose an ethical framework to maintain and promote ethics in government.

Introduction

1.9 Canadians are concerned about integrity in government and they have the right to expect the highest ethical standards in their governments. However, they need to appreciate that ethical standards in government do not exist in a vacuum and that a significant proportion of Canadians also have concerns about the integrity of a number of other institutions and occupations. In addition, they need to appreciate that people in all walks of life face ethical dilemmas and there are indications that, in certain circumstances, individual Canadians may engage in behaviour that would be considered less than ethical.

1.10 We did not undertake this study because we believe that ethical standards in Canadian governments are declining or are worse than those in the private sector. The expectations of Canadians for ethical conduct in the public sector are probably greater than for most of the private sector. Canadians also need to appreciate that they have raised their expectations for ethical conduct in government.

1.11 Nor did we undertake this study because we believe that ethical standards in Canadian governments are worse than those of other countries. We believe that Canadian governments compare very favourably with others in their integrity.

1.12 However, we are concerned by Canadians' increasing cynicism about their public institutions. Whether based on fact or perception, this cynicism is troubling. If Canadians do not trust their governments to act ethically, governments will find that their actions have less and less legitimacy and effectiveness. Thus, we believe that it is important to discuss ethics in government and to take action to

maintain and promote ethics in government.

1.13 We recognize that the subject of ethics in government is very broad and that this chapter addresses only part of the subject. Our focus is on ethics in decision making in government. Ethics in decision making means that decisions are made impartially and objectively, and in the public interest. There are two basic approaches to promoting ethical behaviour in this area. One is based on "rules" and relies on compliance. The other is based on clear values and on actions that promote honesty. While our discussion emphasizes the latter approach, we recognize that any emphasis on ethics must be tempered by past experiences. These indicate that while the promotion of ethical values is necessary, it is not a substitute for cost-effective financial and management controls.

1.14 For some ethical problems — blatant conflict of interest, for example — the answers may be clear. But there are real ethical dilemmas inherent in our political system. Many of these arise when the socio-economic merits of a proposal clash with the political realities of such pragmatic matters as balancing regional interests. The existence of these ambiguities should not discourage discussion, however. Rather, these dilemmas are the very reason why discussion is needed.

1.15 Our specific objectives for the study were:

- to assess public servants' awareness of ethics and fraud;
- to assess the extent of ethics training and other ethics-related initiatives in key federal departments and agencies; and
- to discuss a framework for ethics in government that would apply to all public officials whether elected or appointed.

Canadians are concerned about integrity in government and they have the right to expect the highest ethical standards in their governments.

It clearly would be unfair to place the responsibility for maintaining ethical standards solely on the shoulders of public servants. Leadership by members of Parliament, ministers, and deputy ministers is critical to maintaining ethical standards and performance in government.

1.16 To assess public servants' awareness of ethics and fraud we conducted extensive confidential interviews with public servants in four departments. The interviews focussed on ethical issues related to conflict of interest and fraud. These are easily understood as ethical issues and are concrete: they deal with the opportunity for personal gain or with direction by superiors to make unethical decisions. From those clearly understood issues, the discussion could be expanded to more inherently difficult matters such as the clash between deciding issues solely on their socio-economic merits and giving weight to political considerations. The first part of this chapter presents our findings from these interviews and describes our methodology.

1.17 Although the focus of our interviews was on public servants in four departments, it clearly would be unfair to place the responsibility for maintaining ethical standards solely on the shoulders of public servants. Leadership by members of Parliament, ministers, and deputy ministers is critical to maintaining ethical standards and performance in government. Maintaining ethics in government also is the responsibility of those who supply goods and services to government or receive benefits from government. It is for these reasons that we propose an ethical framework for government in the third part of this chapter.

1.18 The second part of the chapter summarizes the ethics initiatives of the government and ethics training in nine government departments.

1.19 The third part discusses an ethical framework for government. Our proposed framework recognizes the importance of recent government measures and those previously undertaken, the results of our

interviews and consultations with knowledgeable people in the field, a review of the literature and our examination of practices in the public and the private sectors. We propose a number of elements that build upon and help integrate existing government measures into a broader ethical framework for the government.

1.20 Work has already begun on other areas. For example, the 1991 report of *The Royal Commission on Electoral Reform and Party Financing* reviewed concerns about ethics at the political party level and recommended that "each registered party adopt a code of ethics" and "set up an ethics committee to help ensure adherence to and promotion of the code". In addition, on several occasions since 1988, legislation has been proposed to regulate conflict-of-interest matters for members of the Senate and the House of Commons. In March 1995 a report on proposed amendments to the *Lobbyist Registration Act*, entitled "Rebuilding Trust", was tabled in the House of Commons by the Sub-committee of the Standing Committee on Industry.

Findings from Interviews with Public Servants

1.21 Public servants are important to a discussion of ethics because they form a relatively large permanent base for the maintenance and enhancement of a core set of ethical values. These values act as a brake on abuses associated from time to time with the activities of a wide range of individuals, including politicians, political appointees, lobbyists, contractors, public servants themselves, recipients of government benefits, taxpayers and others involved with the government.

1.22 Public servants are also important because, in our system, Parliament does

not direct in detail the activities of ministers and the departments and agencies for which they are responsible. Legislation provides an enabling power to ministers and, by delegation, to public servants to exercise administrative discretion in developing program policies and strategies to implement them. Thus, public servants share in the decision-making process.

Our Approach

1.23 We reviewed the ethics awareness of public servants, including senior managers, in four departments. We proceeded on the assumption that a focus only on senior managers would be too narrow, since job classification alone is not a reliable indicator of the amount of discretion exercised by an employee. Moreover, decision-making discretion is increasing among public servants at all levels as a result of reductions in the size of the public service, government renewal efforts, and changes in financial and management controls. As more public servants wield greater discretion, they need to be aware of ethical issues and have the means to resolve them.

1.24 We conducted confidential interviews in 1993 and 1994 in the following four departments: National Defence, the Canadian International Development Agency, Canadian Heritage and Environment Canada. We chose these departments because they are responsible for a number of different policy, regulatory and operational activities. At the time of our study, the total number of employees in the four departments, including members of the Canadian Forces, was about 120,000. We interviewed 329 public servants randomly chosen from each of the four departments, stratified by senior managers and other public servants. In certain instances the

departments where we conducted interviews have been restructured, so the results cannot be directly associated with the departments as they currently exist.

1.25 For the purposes of our interviews, the term “public servants” was defined as all federal government employees, including senior managers and members of the Canadian Forces, in the foregoing departments. Our use of this term is broader than the legal definition in the *Public Service Staff Relations Act*, which defines “public servants” as those persons “for whom Treasury Board represents the government as the employer”. We defined “senior managers” to include all public servants appointed to the executive category and equivalent military ranks, for example, assistant deputy ministers and directors general and colonels.

1.26 Generally, we report the results of our analysis for all public servants, including senior managers, in the above departments. We also report separately the results for senior managers when the differences in results between senior managers and all public servants is statistically significant. Public servants below the level of senior manager constitute most of the employees in the departments sampled, and the results for this sub-group and all public servants in the departments are virtually the same.

1.27 The results derived from our sample size afford a level of accuracy, on average, of plus or minus about 6 percentage points for all public servants, as well as the sub-group of senior managers, 95 times out of 100. It is at a 95 percent confidence level that the differences we report between all public servants and senior managers reflect real differences that are not the result of random sampling fluctuation. We have rounded the results to the nearest percent.

Maintaining ethics in government also is the responsibility of those who supply goods and services to government or receive benefits from government.

On the whole, public servants in the four departments where we conducted interviews believe that the programs in which they work are administered ethically and that the risk of fraud is low.

1.28 We designed the interviews to obtain information on public servants' awareness of, and concern about, issues of ethics, conflict of interest and fraud in their departments. We use the term "fraud" to include, as well as fraud, other activities that could result in the laying of charges under various sections of the *Criminal Code of Canada*, the *Competition Act* or the *Financial Administration Act*. We sought to determine their knowledge of government policies related to conflict of interest, fraud and other illegal acts. We also asked their views on the appropriateness of certain questionable actions, and what action they would take when faced with suspected fraudulent acts or conflicts of interest.

1.29 However, the reader should not infer from the results of this study that questionable actions would go undetected or that there is a significant level of fraud or other illegal activity in government. Further, our sampling framework applies to the four departments where we conducted interviews; thus the results cannot be generalized statistically to the whole public service.

General Finding

1.30 On the whole, public servants in the four departments where we conducted interviews believe that the programs in which they work are administered ethically and that the risk of fraud is low. On the whole, they could identify questionable conduct and they stated they would take some type of action to report it or stop it. These results indicate that we are starting from a strong base of ethical standards among public servants.

1.31 However, we found some areas of vulnerability. Examples of these can be found in our detailed findings. We are

concerned about them because they could pose a threat to the existing strong base of ethical standards. We also are concerned because even a few infractions, especially if they are widely publicized, can tarnish the reputations of all public servants and undermine public trust in government.

Detailed Findings

Public servants' assessment of ethics in government

1.32 We asked interviewees about the ethics — the honesty and integrity — of their immediate supervisors and their senior managers and whether programs in which they work were administered ethically (see Exhibit 1.1). We found that most public servants believe that ethical standards in their departments are high. For example:

- 86 percent of public servants (93 percent of senior managers) believe that their programs are administered ethically;
- 88 percent of public servants believe that their immediate supervisors are ethical; and
- 77 percent of public servants (84 percent of senior managers) believe that the senior managers of their departments are ethical.

Matters relating to fraud and other illegal acts

1.33 Risk and reporting of significant frauds. On a positive note, most public servants in the four departments — 78 percent (92 percent of senior managers) — consider the risk of fraud or other illegal activities to be low in their departments. Conversely, it is also noteworthy that 22 percent of public servants believe that there is an appreciable risk of fraud in their departments (see Exhibit 1.2).

1.34 Most public servants (91 percent) said they would report a significant fraud or illegal activity if they suspected one. Almost all senior managers (98 percent) said they would report a significant fraud. The main reason given for not reporting was fear of reprisal.

1.35 Knowledge of relevant policies and key controls. We asked public servants about their knowledge of government policies on conflict of interest and fraud and other illegal activities, because these policies provide direction on how to deal with sensitive matters. We recognize that lack of knowledge of specific sections of the policies does not mean that people will act improperly, or vice versa. Nonetheless, the policies are important because they provide a common set of values for the public service and allow the government to hold people accountable for acting improperly.

1.36 The government's key policy on dealing with fraud and other illegal acts against the Crown is the policy on *Losses of Money and Offences and Other Illegal*

Acts Against the Crown. The policy requires, for example, that:

- all losses of money and allegations of offences, illegal acts against the Crown and other improprieties be fully investigated;
- suspected offences be reported to the responsible law enforcement agency;
- departments ensure that employees are aware of and periodically reminded of their personal responsibility under the *Financial Administration Act* to report any knowledge of a contravention of the Act or its regulations; a contravention of any revenue law; any fraud against Her Majesty;
- departments take reasonable measures to protect the identity and reputations of both the persons reporting offences and improprieties and the persons against whom allegations are made;
- departments establish and ensure that employees are aware of procedures to deal with tips about alleged losses, offences, improprieties, and improper practices, however obtained or received and whether anonymous or otherwise;

We found some areas of vulnerability. We are concerned about them because they could pose a threat to the existing strong base of ethical standards.

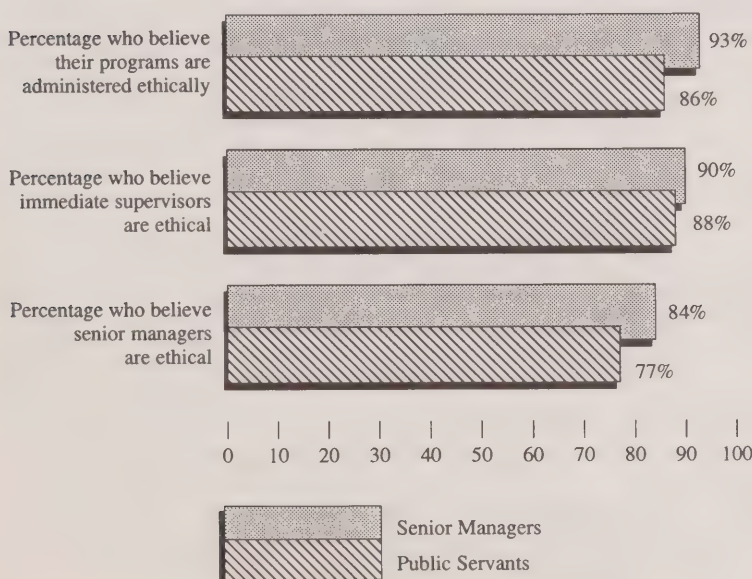


Exhibit 1.1

Public Servants' Assessment of Ethics in Government *

* Refers to senior managers and other public servants in four departments

- managers who fail to take appropriate action or directly or indirectly tolerate or condone improper activity be themselves held to account.

1.37 It is important that senior managers be aware of these policies. The data indicate that there are gaps in knowledge about this policy among senior managers:

- 32 percent of senior managers were not aware of the existence of the "Losses" policy;
- 57 percent of senior managers were either unaware of the policy or could not mention any element of the policy.

1.38 Departments, in response to the *Financial Administration Act* and Treasury Board policies, are expected to have financial and management controls to help prevent fraud or other illegal activities. Such controls include separation of responsibilities, contract tender review boards, or confirmation that the goods and services received meet the contract's specifications. One third of senior managers could not identify more than one key financial or management control that prevents fraud or illegal activities.

Matters relating to conflict of interest

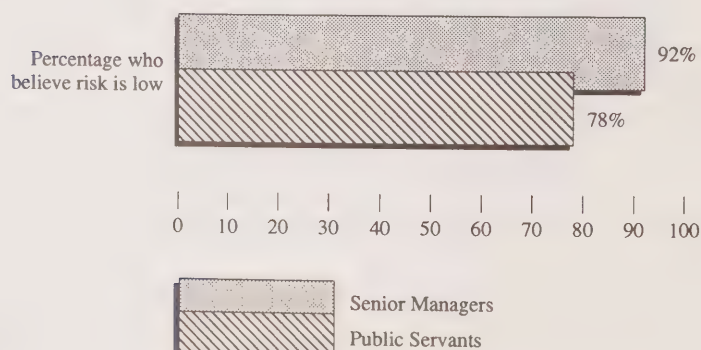
1.39 There are a number of statutes, rules and administrative provisions that regulate conflict of interest in the federal government. The *Criminal Code of Canada*, the *Parliament of Canada Act*, *Rules of the Senate of Canada* and *Standing Orders of the House of Commons* all contain some conflict-of-interest provisions.

1.40 However, the most explicit statements on conflict of interest are the *Conflict of Interest and Post-Employment Code for Public Office Holders* and the *Conflict of Interest and Post-Employment Code for the Public Service*. The former applies to "public office holders" — ministers, secretaries of state, parliamentary secretaries, ministerial political staff and Governor in Council appointees. Its principles in Part I of the Code apply to staff of federal boards, commissions and tribunals, separate employers as defined under the *Public Service Staff Relations Act*, the Canadian Armed Forces and the Royal Canadian Mounted Police. The latter code applies to public servants for whom Treasury Board represents the government as the employer. The codes have been in place in one form or another since 1985. They do not apply to senators and members of

The reader should not infer from the results of this study that questionable actions would go undetected or that there is a significant level of fraud or other illegal activity in government.

Exhibit 1.2

Public Servants' Perception of the Risks of Fraud or Other Illegal Activities *



* Refers to senior managers and other public servants in four departments

Parliament or to employees of Crown corporations.

1.41 The codes contain a statement of principles and rules on permissible and prohibited types of assets and liabilities, outside activities, gifts and benefits, and post-employment behaviour. They also require disclosure of assets or other circumstances that could constitute a potential conflict of interest.

1.42 The codes contain the principles shown in Exhibit 1.3.

1.43 The principles of both codes are the same except for the principle of decision making. Treasury Board has

informed us that it intends to revise by June 1995 the code for public servants of whom Treasury Board is the employer.

1.44 Findings on conflict of interest. On the whole (84 percent), public servants in the four departments where we conducted interviews were aware that the government has a conflict-of-interest policy. Almost all senior managers (98 percent) were aware of the policy.

1.45 Eighty-one percent of these public servants (95 percent of senior managers) believed that the policy is reasonable and justifiable.

1.46 Only 4 percent of public servants (9 percent of senior managers) indicated

Ethical standards. Public office holders shall act with honesty and uphold the highest ethical standards so that public confidence and trust in the integrity, objectivity and impartiality of government are conserved and enhanced.

Public scrutiny. Public office holders have an obligation to perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law.

Decision making. Public office holders, in fulfilling their official duties and responsibilities, shall make decisions in the public interest and with regard to the merits of each case.

Private interests. Public office holders shall not have private interests, other than those permitted pursuant to the code, that would be affected particularly or significantly by government actions in which they participate.

Public interest. On appointment to office, and thereafter, public office holders shall arrange their private affairs in a manner that will prevent real, potential or apparent conflicts of interest from arising but if such a conflict does arise between the private interests of a public office holder and the official duties and responsibilities of that public office holder, the conflict shall be resolved in favour of the public interest.

Gifts and benefits. Public office holders shall not solicit or accept transfers of economic benefit, other than incidental gifts, customary hospitality, or other benefits of nominal value, unless the transfer is pursuant to an enforceable contract or property right of the public office holder.

Preferential Treatment. Public office holders shall not step out of their official roles to assist private entities or persons in their dealings with the government where this would result in preferential treatment to any person.

Insider information. Public office holders shall not knowingly take advantage of, or benefit from, information that is obtained in the course of their official duties and responsibilities and that is not generally available to the public.

Government property. Public office holders shall not directly or indirectly use, or allow the use of, government property of any kind, including property leased to the government, for anything other than officially approved activities.

Post-employment. Public office holders shall not act, after they leave public office, in such a manner as to take improper advantage of their previous office.

Exhibit 1.3

Principles of the Conflict of Interest and Post-Employment Code for Public Office Holders

that they were aware of other employees who were in a conflict-of-interest situation.

1.47 Although the findings are generally positive, further review of the data suggests that some caution is required. Public servants' compliance with the intent of the government's conflict-of-interest policy may be hampered by a limited knowledge about conflict of interest, reservations about its administration, and concerns about the consequences of reporting conflicts of interest involving others. For example:

- Of those who said they were aware of the conflict-of-interest policy, 53 percent (16 percent of senior managers) could not identify a single element of the policy and 72 percent (36 percent of senior managers) could not identify more than one element.
- Overall, 58 percent of public servants (17 percent of senior managers) were unaware of the existence of the policy or its contents (see Exhibit 1.4).
- Eight percent of public servants (14 percent of senior managers) did not think the policy is administered impartially.
- About one third of public servants believed that their job security would be threatened if they were to report a conflict

of interest involving a supervisor or a senior manager.

1.48 Furthermore, Treasury Board's 1992 *Review of the Conflict of Interest and Post-Employment Code and Policy* reported that public servants found the language of the code to be very difficult to understand.

Scenarios of possible conflict of interest and fraud

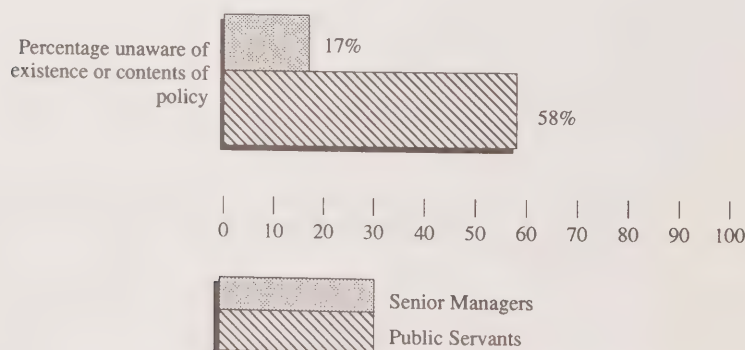
1.49 **Scenarios relating to receiving or conferring benefits.** We presented public servants in the four departments with seven scenarios of possible conflict of interest or fraud and asked them to indicate whether the behaviour described was appropriate and whether they would take any action. Exhibit 1.5 describes the scenarios. Exhibits 1.6 and 1.7 summarize the responses of public servants to the scenarios.

1.50 It is important to note that these scenarios present situations that are not allowed by government policies. Thus, our choice of these scenarios should not be interpreted as suggesting that there is a significant level of abuse in government.

1.51 Four scenarios dealt with the appropriateness of receiving benefits, preferentially conferring benefits or improperly using knowledge of a department. On the whole, public

Exhibit 1.4

Public Servants' Knowledge of Policy on Conflict of Interest *



* Refers to senior managers and other public servants in four departments

servants in the four departments believe it would be inappropriate to receive benefits from suppliers to or recipients of their programs, preferentially confer benefits or improperly use their knowledge of the department.

1.52 For example:

- 89 percent of public servants (96 percent of senior managers) believe it would be inappropriate to accept the use of a ski chalet from a recipient of their contribution or grant program;

- 75 percent of public servants (94 percent of senior managers) believe it would be inappropriate to accept, at cost, goods or services for personal use from a supplier to their program;

- 70 percent of public servants (89 percent of senior managers) believe it would be inappropriate for an employee to hire a brother-in-law on a \$20,000 untendered contract;

- 72 percent of public servants believe it would be inappropriate for a senior manager in a department to use knowledge gained while working to

Exhibit 1.5

Scenario Descriptions and Abbreviations

Abbreviation	Scenario
Accept use of ski chalet	A co-worker is responsible for the delivery of major contribution and grant dollars to support industry in specific activities. The co-worker is using a ski chalet provided by one of his contribution or grant recipients for the weekend without charge.
Purchase goods or services at cost	An employee accepts an offer from a supplier to the employee's program of goods or services at cost for personal consumption.
Hire brother-in-law	The brother-in-law of a departmental employee has set up a consulting company. The employee believes his brother-in-law is one of the best in his line of work. At work, the employee needs to hire a consultant on a \$20,000 contract which, due to its size, does not have to be tendered. The employee hires the brother-in-law.
Use departmental knowledge to secure position	While still with your department a senior manager uses the knowledge gained while working to secure a position with a firm who wants to do business with your department.
Not impose fines and penalties	An employee of your department is requested by a senior manager from your department not to impose penalties and fines against a particular company that is in violation of a departmental regulation, when others in identical violations are being penalized and fined.
Write contract specifications so particular bidder will win	A program needs goods or services and an employee's supervisor believes that a certain company is the best supplier. The supervisor asks the employee to write the specifications in the tender so that only this supplier will win the contract.
Issue questionable sole-source contract	An employee's supervisor tells the employee that a senior manager, or even possibly the minister of the department, is requesting that a sole-source contract for \$50,000 be issued to a particular supplier for certain services or goods. The supervisor instructs the employee to prepare and issue the contract. The employee knows that more than one supplier can provide the goods or services.

secure a position with a firm wanting to do business with the department.

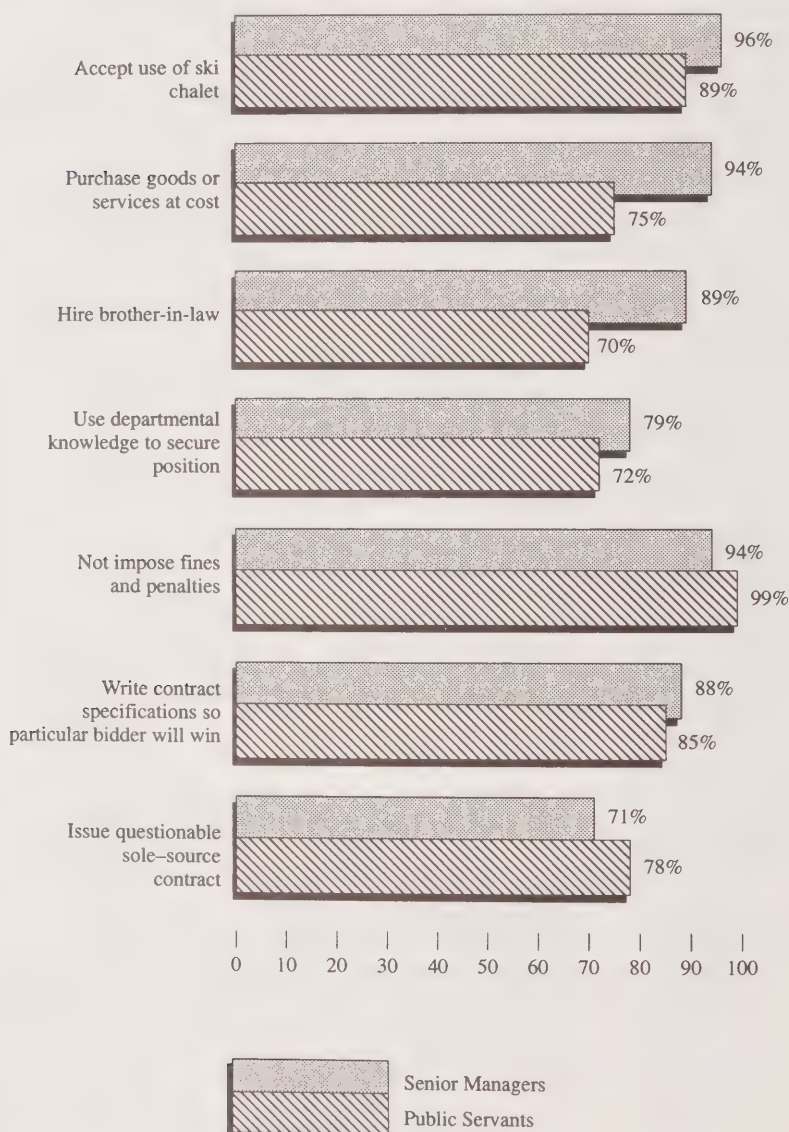
1.53 However, there are some public servants in the four departments where we conducted interviews who believe it is appropriate for an employee to engage in actions that could well constitute a conflict of interest. For example, over 10 percent of public servants believe it would be appropriate to accept the weekend use of a ski chalet from a recipient of their contribution or grant

program. Thirty percent of public servants believe it would be appropriate to hire a brother-in-law on a \$20,000 untendered contract.

1.54 The level of vulnerability among senior managers is generally smaller than for all public servants. However, we were surprised to find that even 4 percent of senior managers in the departments we sampled believe it would be appropriate to accept the use of a ski chalet from a recipient of their contribution or grant

Exhibit 1.6

Percentage of Public Servants Who Believe It Is Inappropriate to Receive or Confer Benefits or Not Make Decisions Impartially and Objectively *



* Refers to senior managers and other public servants in four departments

program. Eleven percent of senior managers believe it would be appropriate for an employee to hire a brother-in-law on an untendered contract. And 21 percent of senior managers believe it would be appropriate for a senior manager in a department to use knowledge gained while working to secure a position with a firm wanting to do business with the department.

1.55 Our concern is heightened by our finding that a noteworthy proportion of public servants would not take some type

of action to stop or report the activities described in the foregoing set of scenarios.

The results are more reassuring for senior managers separately. For each of the first three scenarios, more than 84 percent of senior managers would take some type of action to stop or report the situation. However, only 62 percent of senior managers would take action to stop or report other senior managers who were using knowledge gained while working to secure a position with a firm that wanted to do business with the department.

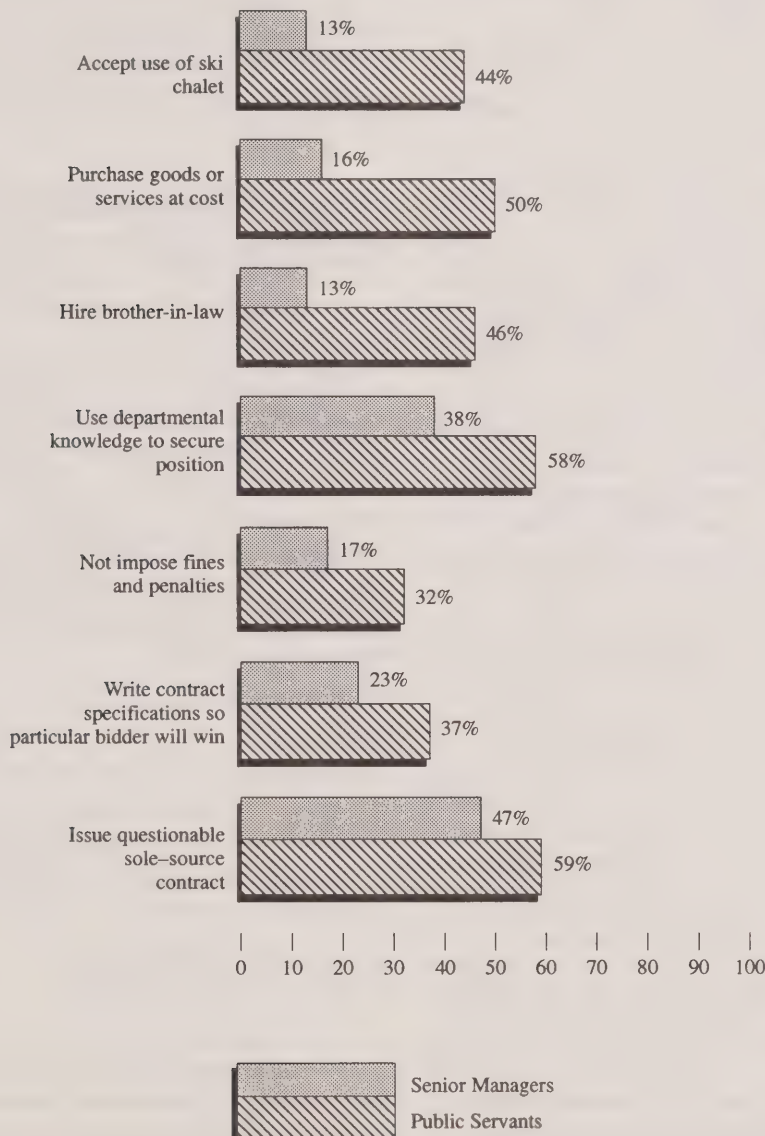


Exhibit 1.7

Percentage of Public Servants Who Would Not Take Action to Stop or Report Possible Conflict of Interest or Fraud *

* Refers to senior managers and other public servants in four departments

The current government has stressed the importance of integrity in government and has stated its intention to restore confidence in the institutions of government.

1.56 Scenarios for impartiality and objectivity. Three other scenarios focussed on making decisions impartially and objectively. The findings for the second set of scenarios were generally similar to those for the first. On the whole, public servants believe that decisions should be made impartially and objectively.

1.57 For example:

- 99 percent of public servants (94 percent of senior managers) believe it would be inappropriate for a government employee, at the direction of a senior manager, to not impose fines or penalties against a particular company although other companies with identical violations were being fined or penalized;
- 85 percent of public servants believe it would be inappropriate for a government employee, at the request of a supervisor, to write contract specifications for a competitive contract in such a way that a particular bidder would win the contract;
- 78 percent of public servants believe it would be inappropriate for a government employee, knowing that more than one supplier could provide the needed goods or services, to issue a \$50,000 sole-source contract at the direction of their supervisor who indicates that this is at the request of a senior manager or the minister.

1.58 However, some areas warrant attention. For example, 12 percent of senior managers believe it is appropriate, at the request of a supervisor, to undermine a competition for a contract. Further, 29 percent of senior managers believe it is appropriate to issue a questionable sole-source contract when a supervisor indicates that a senior manager or the minister has made the request.

1.59 We are also concerned about finding that around one third of public

servants would not take some type of action to stop or report the undermining of a competition or the failure to impose fines or penalties impartially, and 59 percent would not take action in the situation involving a questionable sole-source contract.

1.60 The results for senior managers indicate that 23 percent of senior managers would not take some kind of action to stop or report the undermining of a competition for a contract; 17 percent would not act when fines or penalties were not imposed equitably; and 47 percent would not act when the matter involved a questionable sole-source contract apparently requested by a senior manager or the minister.

Ethics-Related Initiatives by Government

1.61 The current government has stressed the importance of integrity in government and has stated its intention to restore confidence in the institutions of government. On 16 June 1994 the Prime Minister announced several measures to help promote public trust in national institutions. The focus of these measures was on the government's political leaders, government appointees, and lobbyists. The measures included:

- the appointment of an Ethics Counsellor;
- introduction of a lobbyist certification clause in all contracts to prohibit suppliers from hiring lobbyists on a contingency fee basis to help them win contracts;
- proposed amendments to the *Lobbyist Registration Act*; and
- revision of the *Conflict of Interest and Post-Employment Code for Public Office Holders*, in particular the inclusion of the principle that "public office holders,

in fulfilling their official duties and responsibilities, shall make decisions in the public interest and with regard to the merits of each case.”

1.62 Our proposed framework for ethics in government recognizes the importance of these recent measures as well as those taken previously.

1.63 Office of the Ethics Counsellor. The Ethics Counsellor, who reports to the Prime Minister, administers the *Conflict of Interest and Post-Employment Code* for Cabinet ministers, parliamentary secretaries, ministerial staff and full-time Governor in Council appointees. He is available to investigate allegations against public office holders involving conflicts of interest or lobbying.

1.64 Prohibition of contingency fees for obtaining contracts. A clause now in all government contracts prohibits suppliers from hiring lobbyists on a contingency fee basis to help them obtain contracts. Companies must certify that they have not hired a lobbyist whose payment depends on the client winning the contract.

1.65 Proposed amendments to the Lobbyist Registration Act. The *Lobbyist Registration Act* was introduced in 1989. The government has proposed amendments to the Act. The proposed legislation would require lobbyists to file more specific information on their lobbying campaigns with the Registrar, Lobbyist Registration Branch, Industry Canada. It would also authorize the Ethics Counsellor to develop a lobbyists’ code of conduct in consultation with the industry, and to investigate and report publicly on complaints about lobbying activities that run counter to the code.

1.66 Guidelines on polling and advertising contracts. In addition to the measures announced 16 June 1994, the

Minister of Public Works and Government Services had established new guidelines in May 1994 on the awarding of contracts for public opinion research and advertising services. Such contracts are now covered by the government’s general procurement policies. Those policies direct departments to contract for these services on a fair and competitive basis, in accordance with government regulations and policies.

1.67 Revision of the Code. In June 1994 the *Conflict of Interest and Post-Employment Code for Public Office Holders* was revised. Two obligations were added to state that public office holders should make decisions “in the public interest and on the merits of each case” and that they should avoid “preferential treatment to persons or groups based on the individuals hired to represent them.” Other revisions to the code require ministers, secretaries of state and parliamentary secretaries to file confidential reports on the assets and liabilities of spouses and dependants as well as their own.

Ethics and Fraud Awareness Programs

1.68 We reviewed ethics programs and training in the four departments mentioned in paragraph 1.24, and in Foreign Affairs and International Trade, Public Works and Government Services Canada, Transport Canada, the Department of Finance, and Treasury Board Secretariat. We chose these departments because they represent a range of important government activities and together employ about 160,000 people. We also looked at ethics training provided by two central training organizations — Training and Development Canada and the Canadian Centre for Management Development.

A sound ethical framework in government is grounded on the principle that public service is a public trust. It provides some assurance that decisions are made impartially and objectively, and in the public interest.

Although one cannot use the results of our review to generalize statistically to the whole government, we believe they illustrate the nature of current ethics training in government.

1.69 We also obtained information on ethics programs and training in private and public sector organizations in Canada and other countries. These programs use a variety of approaches, including senior management committees on ethics, reports to senior management on ethics in the organization, ethics advisors or ombudsmen, codes of conduct, ethics training programs, periodic surveys to track attitudes, newsletters and articles on ethics in organizational publications. Some organizations also have specific anti-fraud programs, including the development of fraud control plans, anti-fraud training, and the establishment of confidential "hotlines" to report abuses.

1.70 Although there is limited information on the effectiveness of ethics programs in either the public or the private sector, there is some evidence that such programs have a positive impact on the ethics of staff and management, and on their awareness of misconduct and willingness to report it. The literature also indicates that, if the government is to develop and implement such programs, it needs to cover the set of principles common to all parties as well as the unique ethical problems a specific party might encounter.

1.71 Our review of ethics programs and training in nine departments indicates that, in the past, departments approached the issue of ethics by providing some type of training to certain groups of employees. For example, the Department of Justice offers to departments a half-day course focussing on conflict of interest as part of its Legal Awareness Program. Although

there has been a noticeable growth in the number of ethics courses offered in the last few years, relatively few public servants in the selected departments have participated. Two departments, National Defence and Public Works and Government Services, are beginning to develop more comprehensive approaches to promoting ethical conduct. However, less than 6 percent of public servants in the nine departments have taken some kind of ethics-related training.

1.72 We are concerned about this gap in training because the results of our interviews indicate that a notable proportion of public servants are not aware of, or do not understand, the existing conflict-of-interest guidelines and other relevant policies. However, rules and guidelines cannot deal with every circumstance; it is equally important that public servants develop the skills to deal with a range of ethical dilemmas that may confront them. We believe it is important to offer training that deals with both conflict of interest and ethical decision making.

Framework for Ethics in Government

Purpose of an Ethical Framework

1.73 A sound ethical framework in government is grounded on the principle that public service is a public trust. It provides some assurance that decisions are made impartially and objectively, and in the public interest.

1.74 A sound ethical framework makes it clear that certain behaviour is not acceptable in government. It makes it more likely that decisions will be made on the merits of the issue, that explanations for government actions will be acceptable

to the public, and that confidence in government will be enhanced.

1.75 Further, adherence to a sound ethical framework allows the government to focus on the substance of a policy instead of having its priorities eclipsed by charges of conflict of interest or political favouritism.

1.76 An ethical framework also makes it clear that appearances surrounding a decision are important. A public official who accepts gifts or hospitality from those who could be perceived as being interested in influencing a decision should not be surprised when the public believes the official's judgment has been influenced. In the end, the perception undermines confidence in the integrity of government as effectively as actual fraud or conflict of interest covered by the criminal law.

1.77 The ethical framework that we propose builds upon and incorporates existing government measures that already seek to ensure that decisions are made in the public interest. Exhibit 1.8 summarizes the elements of the proposed framework.

Possible Elements of the Framework

A statement of principles

1.78 A core set of basic principles is needed to help ensure that all relevant groups share and understand a common set of values and expectations about ethical standards in government. The current conflict-of-interest principles are satisfactory and, for the most part, already apply to public office holders and public servants. The principles require public office holders and public servants to perform their duties in a way that conserves and enhances public confidence and trust in the integrity, objectivity and impartiality of government (the specific principles are described in Exhibit 1.3).

1.79 These general principles need to be supplemented by a commentary section elaborating on the principles' meaning. For example, public office holders are expected to conform to the principle that decisions should be made in the "public interest" and with regard to the "merits of each case". The meaning of this principle needs to be clarified by examples to illustrate the kinds of situations that may be encountered by public office holders

- **A Statement of Principles** to ensure common understanding that public service is a public trust.
- **Leadership** by the Prime Minister, ministers, Clerk of the Privy Council and deputy ministers to maintain ethical standards in government.
- **Public Servants** who are empowered to carry out their duties in the public interest and resist pressure to do otherwise.
- **Transparent Decision Making** to allow people to judge whether public office holders are acting in the public interest.
- **Ethics-Related Training** to develop knowledge and skills to maintain and enhance ethics.
- **A Mechanism for Discussing and Reporting Ethical Concerns** so that public servants can voice concerns without fear of reprisal.
- **A Continuous Process** which makes ethics a conscious and visible part of day-to-day decision making.

Exhibit 1.8

Possible Elements of an Ethical Framework

The government needs to forthrightly communicate its core set of ethical standards to groups and individuals dealing with government, with a clear indication that it expects these standards to be respected.

and how they can or should resolve the ethical issues. This would help ensure that the implications of the principles are clear and that there is a common understanding of “public interest” and the “merits of each case”.

1.80 As indicated previously, public office holders and public servants cannot be expected solely to shoulder the responsibility for maintaining the viability of these principles. Thus, the government needs to forthrightly communicate its core set of ethical standards to groups and individuals dealing with government with a clear indication that it expects these standards to be respected. This core set of principles also could be a model that could be drawn upon by these groups to create codes of ethics that would apply to their specific situations.

1.81 There are other matters that the government may wish to consider in terms of the scope and application of its ethical standards. For example, the current principles do not explicitly address issues such as privacy, confidentiality and harassment. In addition, they do not apply to such government activities as Crown corporations, and ventures involving partnerships with the private sector or other governments.

Leadership

1.82 Even the best codes of conduct or conflict-of-interest guidelines could not protect Canadians from a government that was not fundamentally honest. To concentrate on public servants without emphasizing the role of leadership by ministers, deputy ministers and other senior levels would simply contribute to the existing cynicism among public servants. The literature on ethics and fraud emphasizes the importance of leadership and of the examples set by leaders in determining the ethical tone of

an organization. Our discussions with former senior public servants also suggest the importance of support at the top to counter unethical acts.

1.83 As Michael Starr and Mitchell Sharp noted in their 1984 report, *Ethical Conduct in the Public Sector*, “A large measure of the responsibility rests with the Prime Minister in relation to matters of ethical conduct in the public (because) the Prime Minister sets the tone for the entire government.” The actual and perceived day-to-day behaviour of leaders such as the Prime Minister, Cabinet ministers and senior public servants must be consistent with the government’s ethical guidelines. The government’s recent initiatives reflect its concern about the importance of leadership.

1.84 Leadership at the intersection of politics and administration is critical. Traditionally, deputy ministers have viewed the Clerk of the Privy Council as their advocate with the Prime Minister when they encounter ethical dilemmas involving their ministers. Public servants have viewed their deputy ministers as their advocate with the minister’s office. The role of the Clerk of the Privy Council and deputy ministers as guardians of the integrity of the public service needs to be clearly established. All parties need to have a mutual and clear understanding of their respective roles and responsibilities. This may require that the responsibilities of the Clerk of the Privy Council and deputy ministers for such matters be specifically defined.

The role of the individual public servant

1.85 We believe that the vast majority of public servants are honest and dedicated to carrying out their duties in the public interest. They have a large role to play in maintaining an ethical climate in government.

1.86 Ethics cannot be left only to ministers and senior officials. We believe that public servants have to be empowered to carry out their duties in the public interest and to resist pressures to do otherwise. It must become normal for employees to state their reservations about actions that they consider to be of questionable ethics. Decision makers at all levels have an obligation to listen. Moreover, although the government has a right to require that public servants maintain confidentiality about government actions, it has a clear reciprocal obligation not to ask employees to act contrary to the conflict-of-interest principles such as those relating to public scrutiny, decision making and preferential treatment.

Transparency of decision making

1.87 As we have noted, the government revised the *Conflict of Interest and Post-Employment Code* to state that “public office holders, in fulfilling their official duties and responsibilities, shall make decisions in the public interest and with regard to the merits of each case.” We endorse this principle.

1.88 In our view, however, an essential complementary principle is needed: that is, ministers must be as open as possible about the reasons for their decisions. Without the greatest possible degree of transparency, there is little basis for others to judge whether public office holders are acting in the public interest and with regard to the merits of each case, and that decisions have been made impartially and objectively.

1.89 In some areas, for example national security, governments may not be able to be as forthcoming as in others. However, in general we believe that if there is a clash between transparency and

secrecy, the conflict should be resolved in favour of transparency.

1.90 Of course, attempts to veil political decisions under another guise — for example, a biased cost-benefit analysis — are unacceptable. Such attempts violate the principle of honesty in government and undermine the morale and ethics of all involved in the subterfuge. For the same reasons, attempts by lobbyists or other interested parties to influence public policy and decisions should be open to public scrutiny.

Ethics-related training

1.91 The goal of ethics training is to help develop the knowledge and skills to maintain and enhance ethics in government and to ensure that leadership and decision making are honest, in the public interest and as transparent as possible.

1.92 Discussion of ethical issues is a key way to achieve these goals. It is important that all parties, particularly senior managers, be able to recognize the ethical dimensions of their work and of government as a whole. Ethics-related training would provide information on ethical values and formal rules in government. It would provide public servants with the tools to deal with ethically questionable requests from ministers and superiors and it would also provide an opportunity to discuss the ethical dilemmas people have encountered. Training would be offered to all parties and would include workshops attended by people from various levels.

A mechanism for discussing and reporting ethical concerns

1.93 Public servants need a clearly designated place where they can go to discuss or report ethical issues they encounter. The *Financial Administration*

We believe that the vast majority of public servants are honest and dedicated to carrying out their duties in the public interest.

Act requires that public servants report any knowledge of suspected fraud or illegal activity to any supervisor. We believe that there should be a number of options available to voice a concern not only about suspected illegal activity but also about transgressions of ethics. In some cases, it may be best to take up an issue with a supervisor. However, it must be acceptable for an individual to go elsewhere — perhaps to an independent ombudsman or ethics advisor. It is also important that an individual wishing to discuss or report an ethical concern be able to do so without fear of reprisal. There are several mechanisms that could be considered, including the type of “whistle-blower protection” legislation passed by the Ontario government. A thorough discussion of the advantages and disadvantages of alternative approaches is needed.

The enhancement of ethics in government as a continuous process

1.94 Ethics must be kept on the agenda. This means that codes need to be reviewed from time to time for relevance; ethics-related training should be offered periodically; and political leaders and senior public servants should support these efforts in speeches and correspondence. However, words alone are not enough. The success of such an ethics program will, in the end, largely depend on making it a conscious and visible part of day-to-day decision making.

Summary and Conclusions

1.95 Canadians are concerned about integrity in government and they have the right to expect the highest ethical standards in their governments. However, they need to appreciate that these ethical standards do not exist in a vacuum. They are influenced by those in the private

sector as well as those of individual Canadians.

1.96 We believe that ethical standards in government compare very favourably with those in the private sector and with those of governments of other countries. However, Canadians are concerned about integrity in government. If Canadians do not trust their governments to act ethically, governments will find that their actions have less and less legitimacy and effectiveness. Thus, we believe that it is important to discuss ethics in government and to take action to maintain and promote ethics in government.

1.97 To advance the discussion on ethics, we have set out elements of a possible framework for ethics in government, resting on basic principles that would be shared by all stakeholders and would be tailored to address ethical issues and dilemmas that may confront specific parties. Although we have reported the results of interviews with public servants, it would be unfair to place the responsibility for maintaining ethics in government solely on the shoulders of public servants. Leadership by members of Parliament, ministers, and deputy ministers is critical to maintaining ethical standards and performance in government. Maintaining ethics in government also is the responsibility of those who supply goods and services to government or receive benefits from government.

1.98 Public servants, however, play an essential role in preserving a core set of ethical values that act as a brake on internal and external sources of abuse affecting integrity in government.

1.99 Public servants share increasingly in the decision-making process. Decision-making discretion at all levels of the public service is growing as a result of reductions in the size of the public service, government renewal, and changes

in financial and management controls. As public servants wield greater discretion, they need to be aware of ethical issues and to have the means to resolve them.

Increased discussion of ethics in the making of specific decisions will help all parties to support ethics in government.

1.100 We have presented our findings on ethics and fraud awareness from interviews with over 300 public servants in four departments. The results indicate that we are starting from a strong base of ethical standards among public servants. However, we found some areas of vulnerability. We are concerned about them because they could pose a threat to the existing strong base of ethical standards and because even a relatively few unethical acts can negatively affect the workplace environment and diminish the government's integrity in the eyes of the public.

1.101 To address these vulnerabilities, we have reviewed possible strategies to heighten ethical awareness and minimize the risk of not only fraud but also other unethical behaviour. Clearly, a multifaceted approach as described in our framework for ethics in government is needed to strengthen the ethical climate of government; for example, making ethical considerations a conscious and visible part of day-to-day decision making, clarifying statements of principles, providing training in ethics, and establishing mechanisms for discussing and reporting ethical concerns.

1.102 In summary, enhancing and maintaining ethics in government rests on the principle that public service is a public trust. The objective of our efforts is to help ensure that this principle is the cornerstone of Canadian public administration.

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 2
Environment Canada: Managing
the Legacy of Hazardous Wastes

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 2
**Environment Canada: Managing
the Legacy of Hazardous Wastes**



May 1995

This May 1995 Report comprises 8 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 2

**Environment Canada: Managing
the Legacy of Hazardous Wastes**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Environment Canada: Managing the Legacy of Hazardous Wastes

Assistant Auditor General: Robert R. Lalonde

Responsible Auditors: Wayne Cluskey and Cameron Young

Main Points

2.1 In 1989, the Canadian Council of Ministers of the Environment approved \$250 million in funding for the National Contaminated Sites Remediation Program to develop technology and clean up contaminated sites. When funding for this joint federal-provincial program ended on 31 March 1995, no national plan or federal fund had been created for cleaning up the remaining contaminated sites that pose risks to human health and the environment.

2.2 Comprehensive and consistent information on the number and characteristics of contaminated sites in Canada is not available. This information is essential for estimating clean-up costs and planning action on high-risk sites.

2.3 As of 31 March 1995, only 11 of 48 high-risk contaminated sites identified for remediation under the National Contaminated Sites Remediation Program had been fully remediated under federal-provincial agreements. In 1995–96, Environment Canada plans to continue the clean-up of up to 13 of the remaining 37 sites, which are in various stages of remediation. Several sites still pose risks to human health and the environment.

2.4 The Department has not proposed amendments to the *Canadian Environmental Protection Act* (1988) or developed regulations under the Act that could help ensure adequate control of environmental risks associated with federal facilities and lands, including the clean-up of federal contaminated sites. However, it has provided an analysis of the issues and options available to the House of Commons Standing Committee on Environment and Sustainable Development, which is currently reviewing the Act.

2.5 The Department did not meet a requirement to report to Cabinet by late 1992 on the clean-up of federal sites and the adequacy of funds for this purpose. Preliminary studies indicate that the clean-up will probably cost at least \$2 billion, but better information is needed on the number and characteristics of sites. In addition, none of the potential liabilities have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada.

2.6 Furthermore, the Department has not provided Parliament with adequate information through its Part IIIs of the Estimates on actual costs incurred by the National Contaminated Sites Remediation Program, on Program results, on significant constraints to achievement of Program objectives, or on Program funds used for other purposes. However, the Department has made a significant contribution to annual reports on the Program by the Canadian Council of Ministers of the Environment.

2.7 The use of polychlorinated biphenyls (PCBs) and the storage and destruction of federal PCB wastes are controlled under the regulations of the *Canadian Environmental Protection Act* to minimize risks to human health and the environment. In 1990, the Green Plan called for destruction of all federal PCBs by 1996. However, the federal PCB Destruction Program, which had been in effect since 1988, ended on 31 March 1995. Moreover, lack of public approval is delaying the process of siting destruction facilities, and equipment containing PCBs remains in service. Therefore, the risks of accidents and the costs of storage will continue into 1996 and beyond.

Main Points (cont'd)

2.8 On 31 March 1995, Environment Canada terminated its leadership role in the management of PCB destruction, without devising a plan to guide federal departments to further consolidate PCB wastes, reduce their volume and develop action plans for their destruction. This could seriously impede the government's ability to ensure safe and cost-effective storage and timely destruction of federal PCB wastes.

Introduction

2.9 This chapter deals with certain aspects of federal management of non-radioactive hazardous wastes (Exhibit 2.1), specifically Environment Canada's management of the remediation of contaminated sites, the storage and destruction of polychlorinated biphenyls (PCBs) and the disposal of wastes at sea. Chapter 3 deals with federal management of radioactive wastes.

Background

2.10 **Canada is a major producer of wastes.** The Green Plan (1990) states that

Canadians produce annually over 30 million tonnes of solid waste, or more than a tonne per person. Only 10 percent of this is recycled; most of the rest goes into landfills. Canadians also produce 8 million tonnes a year of hazardous waste, only 40 percent of which is treated. The rest is sent to landfills or discharged into municipal sewers. In addition, in excess of 6 million tonnes of waste, mainly dredged material, are dumped at approved ocean disposal sites annually, and large quantities of hazardous wastes are released as air emissions.

Canada is a major producer of wastes.

2.11 **Federal and provincial roles in waste management.** The provincial and

Waste: Any product, substance or organism that is no longer of use to its owner/generator and is consequently discarded.

Contaminant: Any physical, chemical, biological or radiological substance in air, soil or water that has an adverse effect.

Solid waste: Garbage collected from households and commercial, institutional or industrial sources that requires recycling, composting, incineration or disposal in landfill.

Hazardous waste: Any solid, liquid or gaseous material that is considered harmful to human health or to other living organisms due to its toxic, radioactive, flammable or infectious properties and that requires special disposal techniques to eliminate or reduce the hazard.

Hazard: The harmful effect of a contaminant or waste, usually evaluated according to the type and magnitude of the physical, chemical, biological or radiological effects associated with exposure to the contaminant or waste.

Liquid wastes: Discarded liquids from domestic, commercial or industrial processes.

Air Emissions: Unwanted by-products of human activity that are released into the air.

Orphan Contaminated Site: A contaminated site for which the responsible party cannot be identified or is unable or unwilling to initiate remediation.

National Contaminated Site: Any contaminated site not on federal lands.

High-Risk Contaminated Site: A site that poses an existing or imminent threat to human health or the environment by virtue of the toxicity of its contaminants, the lack of their containment or its proximity to human habitats and sensitive environments.

Remediation: The management of a contaminated site so as to prevent, minimize or mitigate damage to human health or the environment. Remediation options may include, but are not limited to, direct physical actions, such as treatment, removal or destruction of contaminants, or other on-site risk management solutions, such as capping or containment of contaminants or even benign neglect.

Exhibit 2.1

Glossary of Terms

The legacy of the production and mishandling of wastes haunts present and future generations.

municipal governments have the prime responsibility for the collection, treatment and disposal or release of all kinds of waste, except for radioactive wastes. Because of their powers over land-use planning, except on federal lands, the provinces control the siting and operation of storage and transfer facilities for hazardous materials and disposal facilities for wastes. Provincial powers extend to the clean-up of contaminated sites and the approval of remediated sites for industrial, agricultural or housing purposes.

2.12 The federal government has responsibility for federal lands, and its departments and agencies are responsible for the reduction and management of their own wastes, including radioactive wastes, and the clean-up of their own contaminated sites. The federal Code of Environmental Stewardship (1991) provides general guidelines to departments and agencies for “putting the federal house in order”.

2.13 Public attitudes. In 1993, the Canadian Council of Ministers of the Environment (CCME), the major intergovernmental forum for discussion and joint action on environmental issues, found that when rating environmental problems, Canadians rank hazardous waste second only to ozone depletion. However, in spite of the priority given to hazardous waste, the proposed solutions to waste disposal problems have not always been acceptable to the public.

2.14 Impacts of waste generation. The cost of collecting and disposing of waste in Canada has risen steadily over the past decade and is now estimated by Environment Canada to exceed \$4.5 billion annually. This cost has been offset, to some extent, by reducing the kinds and amounts of waste produced and sent for disposal. The resulting economic and environmental benefits include

reductions in spending on clean-up of contaminated sites, more efficient use of energy and raw materials, improved competitiveness and fewer health and environmental problems associated with smog, the ozone layer and global warming.

2.15 The legacy of the production and mishandling of wastes haunts present and future generations. Current landfills are filling up, and siting new ones is becoming increasingly difficult and costly. Contaminated sites resulting from past disposal practices and accidental spills and leaks exist in many communities across Canada. However, no one knows the number of sites, the extent and severity of the contamination, or the total liability for clean-up costs. Now and for many decades to come, we will need to closely manage our wastes and lands contaminated by wastes because of the danger to our health and the environment.

Audit Scope and Approach

2.16 This audit examined Environment Canada’s management of its responsibilities under the joint federal-provincial National Contaminated Sites Remediation Program (NCSRP) and the Department’s administration of the PCB regulations on use, storage, export and treatment/destruction under the *Canadian Environmental Protection Act* (CEPA). The audit included a review of the Department’s efforts to site regional facilities for PCB destruction. In addition, we reviewed the Department’s internal audit of the ocean disposal program, which focussed on the Ocean Dumping Control Action Plan.

2.17 Our audit did not address the management of the wastes of individual departments or their progress in assessing and cleaning up their own contaminated sites. The Office will address federal

government-wide waste management and contaminated site clean-up efforts in a future audit.

Audit Objectives

2.18 The objectives of the audit were to assess the results and report on the costs of the Department's contribution to the National Contaminated Sites Remediation Program and the PCB treatment and destruction program, and to provide a status report on the implementation of the ocean disposal program.

Audit Criteria

2.19 We expected to find that the Department had the following:

- clearly defined roles and responsibilities for administering the programs relating to contaminated site remediation, PCB treatment and destruction, and ocean disposal;
- adequate priorities, plans, procedures and information to fulfil its roles and responsibilities and to support its expenditures on the programs; and
- procedures in place to measure progress on the attainment of the program objectives and to report to Cabinet and Parliament on the costs and results of expenditures and activities against plans, on any constraints to the achievement of the program objectives and on any outstanding liabilities associated with these programs.

Observations and Recommendations

The Clean-up of Contaminated Sites

The need for a national remediation program was recognized

2.20 The sources and types of contaminated sites in Canada are varied

and include active and abandoned hazardous waste landfills, residues of spills, leaks from underground storage tanks, and improperly decommissioned industrial facilities and mine tailings.

Many of these have resulted from what are now considered improper management practices. In 1989, the Canadian Council of Ministers of the Environment estimated that there were approximately 1,000 contaminated sites in Canada and that it would cost \$3 billion to clean them up. The Council also estimated that 50, or 5 percent, of these sites were "orphan" sites, that is, sites for which the parties responsible could not be identified, or were unable or unwilling to initiate remedial measures.

2.21 In April 1989, the Council reached an agreement-in-principle to establish the \$250 million federal-provincial National Contaminated Sites Remediation Program to clean up high-risk orphan sites. This five-year Program, which began in 1989-90, was funded equally by the two levels of government. The objectives of the Program are to ensure the clean-up of all contaminated land sites in Canada, to promote the development of the Canadian environmental technology industry and to clean up federal sites. The federal half of Program funding is supplemented by an extra \$25 million for cleaning up federal contaminated sites.

Management strategies to clean up Canadian contaminated sites were developed

2.22 Federal-provincial co-operation. The federal government ratified its participation in the National Contaminated Sites Remediation Program in October 1989 and subsequently extended funding to 31 March 1995. This was to allow provinces to take advantage of federal funding for a full five-year

The National Contaminated Sites Remediation Program was to ensure the clean-up of all contaminated land sites in Canada.

The Green Plan (1990) committed the government to the clean-up of 30 high-risk orphan contaminated sites.

term. In 1990, the Green Plan committed the government to the clean-up of 30 high-risk orphan contaminated sites under the Program.

2.23 Implementing bilateral agreements. Between November 1990 and September 1993, bilateral agreements to govern funding for the clean-up of high-risk orphan sites and related technology development were signed by the federal government, all provinces and both territories. The agreements define a "high-risk" contaminated site as a location that Canada and the provinces agree poses an existing or imminent threat to human health or the environment. When the Department accepts a clean-up project on the basis of information provided by the province and its own criteria, it negotiates a workplan, reviews progress claims and reimburses the province for 50 percent of eligible costs incurred.

2.24 Establishing eligibility of proposed clean-up projects. The Canadian Council of Ministers of the Environment established Interim Environmental Quality Criteria and the National Classification System (NCS) for the assessment and clean-up of sites. The Criteria set the standards against which the extent of contamination is defined and provide the benchmarks for clean-up goals. These Criteria were gathered from existing provincial criteria and are considered "interim" in that they have not yet been scientifically validated. The NCS is used to assess the risks to the environment and human health and to set priorities for further action, such as characterization, risk assessment or clean-up. The NCS considers the nature of the contaminants, the means or pathways by which the contaminants could enter the food chain and the extent to which humans and sensitive environments are exposed to and affected

by contamination. The use of the National Classification System was mandatory for funding under the National Contaminated Sites Remediation Program.

2.25 Defining the need for new clean-up technologies. When the National Contaminated Sites Remediation Program was approved, there was a shortage of cost-effective technologies to treat and remove contaminants from soils and sediments. The objectives of the Development and Demonstration of Site Remediation Technology (DESRT) component of the Program are to promote and accelerate the development and commercialization of innovative technologies that deal with the characterization, assessment, remediation and monitoring of contaminated sites.

2.26 Under DESRT, projects submitted on an unsolicited basis by the private sector for joint federal-provincial review and approval were supposed to have the potential for wide application at contaminated sites across Canada or relate to a serious problem at one site. Therefore, in March 1992, the Department conducted a study of the needs for remediation technologies as a basis for setting priorities for project approval. The results provided a preliminary screening tool for the suitability of proposed projects.

2.27 Getting the federal house in order. The federal sites component of the National Contaminated Sites Remediation Program (NCSRP) was approved to clean up sites for which the federal government was the owner or responsible polluter. The primary focus of the component was to assess federal sites using the National Classification System. This approach was designed to encourage departments to assess sites in a consistent manner. Assessment costs were shared between the departments involved and the NCSRP.

The National Contaminated Site Remediation Program was to ensure that "polluter pays" legislation was developed and implemented by each province.

Departments were expected to fully fund the clean-up of their own contaminated sites. However, the costs of cleaning up federal orphan sites were shared with Environment Canada under the NCSRP. Environment Canada defines a federal orphan site as a site where a party other than a federal department or agency is responsible for contamination of federal land, but is unknown, unwilling or financially unable to carry out the remediation. Crown corporations were not eligible for funding under the NCSRP.

An adequate legislative framework is not yet in place

2.28 Progress toward a national “polluter pays” legislative framework. One of the objectives of the NCSRP was to ensure that legislation based on the “polluter pays” principle was developed and implemented by each province. Accordingly, the bilateral agreements stipulate that the provinces be given the authority to make sure that the parties responsible for the contamination, or the owners of the contaminated properties, carry out the necessary remedial measures and recover costs where clean-ups had been undertaken by the provinces. Subject to legislative approval, this authority was to be in place by 31 December 1991.

2.29 In January 1993, the Department analyzed the provincial and federal legislative frameworks against five criteria established in 1991 by the Canadian Council of Ministers of the Environment and forwarded the results to the provinces for their action. Subsequently, in March 1993, a CCME multistakeholder Liability Task Group proposed 13 principles for effective legislation governing the remediation of contaminated sites, in which the “polluter pays” principle was paramount. The Department indicates

that provincial legislative frameworks for the clean-up of contaminated sites are currently being developed or, where already in place, are in the process of being strengthened to reflect these principles. However, the Department has not done an analysis since January 1993 on which to base this claim.

2.30 The *Canadian Environmental Protection Act* provides authority to undertake emergency measures to address any danger to human health or the environment resulting from the release of toxic substances. However, this authority applies to parties who owned substances at or before the time of their initial release into the environment. Also, the list of toxic substances under the Act is not exhaustive and may not include the types of contaminants found at existing contaminated sites. Two departmental studies indicate that it is unclear whether or not the Act can be applied to ensure clean-up of contamination resulting from long-term leaching or historical releases of contaminants. As well, one of the studies pointed out deficiencies in the Act’s provisions to recover government expenditures on the clean-up of sites contaminated by other parties.

2.31 **Legislative framework for controlling contamination on federal lands.** In spite of the intent of the federal Code of Environmental Stewardship to put the federal house in order, there still are no regulations under the Act that the Department could apply to ensure the clean-up of federal contaminated sites. The Department says that it is planning to issue CEPA guidelines in the near future on the management of federal underground and aboveground fuel storage tanks, which are common sources of contamination. As guidelines, however, may not legally enforceable. Therefore, the Department’s legislative

The Department’s legislative framework for dealing with federal lands is not comparable to the frameworks that the provinces use for dealing with non-federal lands.

A national inventory of contaminated sites, including orphan sites, does not exist.

framework for dealing with federal lands is not comparable to the frameworks that the provinces use for dealing with non-federal lands. The Department has provided an analysis of the Act and options for changes to the House of Commons Standing Committee on Environment and Sustainable Development. The Committee is currently reviewing the Act and will be reporting later in the year.

The nature and extent of the contaminated site problem has not been fully defined

2.32 A national inventory of contaminated sites, including orphan sites, does not exist. Among the intended activities of the National Contaminated Sites Remediation Program were the development of a national inventory and the assessment of potentially contaminated sites in Canada for the purpose of prioritizing clean-up of problem sites. In 1990, the Department developed requirements and identified possible provincial sources of information for an inventory. However, we have been advised that the members of the Canadian Council of Ministers of the Environment were unable to reach an agreement on the scope and potential use of such an inventory.

2.33 In March 1992, the Department studied the nature of contamination in Canada to determine requirements for new remediation technologies. One of the conclusions of this study was that existing inventories of contaminated sites probably under-represented the incidents of subsurface contamination from active and inactive industrial activities and municipal landfills that received industrial waste.

2.34 In December 1993, the Department developed summary information on all known contaminated

sites for the CCME Liability Task Group, which was reviewing the need for an orphan site fund beyond the scheduled end of the NCSRP. The information provided showed that, as of that date, there were approximately 4,500 contaminated sites in Canada, one third of which had already been cleaned up. However, this information is generally recognized as being incomplete.

2.35 Estimates of clean-up costs for Canada's contaminated sites vary widely. Estimates reported in the media of total clean-up costs for Canada range between \$5 billion and \$20 billion. However, the basis of these estimates was not provided. The national cost of remediating contamination caused by leaking underground storage tanks alone was estimated in a study done for the Department in January 1994 to be as high as \$5.9 billion. This liability was based on an estimated 40,000 leaking underground storage tanks in Canada. However, two factors are missing that would be essential in any estimate of the total liability for cleaning up Canada's contaminated sites — a complete and consistent national inventory and an assessment of contaminated sites.

2.36 The inventory of contaminated federal sites is not complete. The Department has developed an inventory of federal contaminated sites from existing records of spills and data supplied by government departments. As at 31 January 1995, the departmental inventory listed approximately 1,200 potentially contaminated federal sites. This inventory, however, is incomplete. For example, one of the Department's regions identified 25 percent more federal sites with potential sources of contamination than were listed for this region in the federal inventory.

The inventory of contaminated federal sites is not complete.

2.37 The Department should develop adequate information, including an inventory, on all national and federal contaminated sites so that related health and environmental risks and clean-up costs can be determined and reported to Parliament.

2.38 Costs for clean-up of federal contaminated sites could be significant.

In June 1993, the Department undertook a survey of 53 departments, agencies and Crown corporations as the basis for a planned report to Cabinet on the adequacy of the fund to clean up federal sites.

Based on the 46 responses received, the study estimated that there were 2,000 to 3,000 potentially contaminated federal sites, of which 500 to 1,000 would require remediation. The projected cost of assessing and remediating these sites was a minimum of \$1 billion. However, this estimate did not include figures for the Department of National Defence (DND) lands, Indian Reserve lands or vacant Crown lands in the Yukon and Northwest Territories. Our 1994 Report noted that the estimated cost of cleaning up DND's contaminated sites alone and ensuring compliance with environmental authorities was over \$700 million.

2.39 It is unlikely that leaking underground storage tanks were included in Environment Canada's June 1993 survey. The 1994 study on storage tanks referred to earlier estimated that clean-up of this source of contamination on federal lands alone could be approximately \$294 million. This was based on an estimated 2,000 leaking federal tanks and an average clean-up cost of \$147,000 per site. The total potential clean-up cost for federal contaminated sites therefore is probably at least \$2 billion. None of this potential liability has been disclosed in the Notes to the Financial Statements and in

the Notes to the Annual Financial Report of the Government of Canada.

2.40 The Government of Canada should disclose in the Notes to the Financial Statements and in the Notes to the Annual Financial Report those potential federal liabilities related to contaminated site clean-up that it can determine and reasonably estimate.

Treasury Board Secretariat's response: The government is aware that generally accepted accounting principles, as issued by the Canadian Institute of Chartered Accountants, call for recognizing environmental and site restoration costs and liabilities in financial statements. While some forecasts of costs may be available within the Government of Canada for the clean-up of specific items such as radioactive waste and site contamination, this is not the case for other environmental liabilities that the government is committed to address. The cost to the government of all these commitments is not determinable at this time, and until reasonable estimates of these costs can be made, the government should not change its accounting policies to record partial costs. The determination of these costs, which are subject to and dependent upon evolving public policy, legislation and regulation, is currently under study. Where feasible, the note disclosure in the government's summary financial statement for fiscal year 1994-1995 will be enhanced to include those potential liabilities that can be determined and reasonably estimated.

There has been some progress in dealing with the contaminated site problem

2.41 Cost of clean-up activities on known non-federal orphan sites. As at 1 September 1994, the Department had approved 48 high-risk orphan sites as eligible for funding and spent approximately \$42 million on clean-up activities. The sources of contamination at the 48 orphan sites approved to date are

The potential clean-up cost for federal contaminated sites is probably at least \$2 billion.

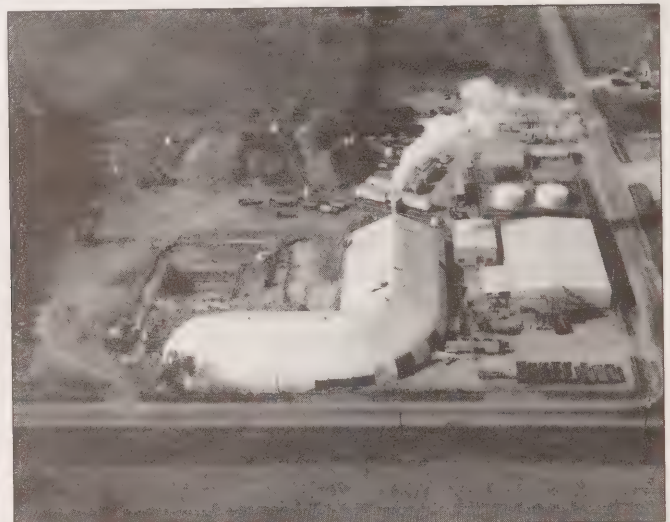
shown in Exhibit 2.2. Groundwater contamination, which usually requires long-term remediation strategies to control the migration of contaminants, was also present at 22 of the 48 orphan sites.

2.42 Total clean-up costs are unclear. The Department had estimated that 11 of the 48 orphan site remediation projects under way would be completed, according

to the approved work plans, by 31 March 1995. The Department also made plans to continue working on up to another 13 of the remaining projects over the following year under its sunseting strategy, as outlined in 2.60. However, this does not mean that the 24 sites will be fully remediated by 31 March 1996 or that there will not be ongoing costs for monitoring and maintaining the sites after

Activity on Contaminated Sites

DESRT project testing bioremediation process on contaminated soil (see paragraph 2.47).



Temporary incinerator destroying PCBs in contaminated soils and liquids at orphan PCB transfer facility (see paragraphs 2.53 and 2.74).

Former oil-coal gasification site, one half converted to fertilizer production, now orphan and partially cleaned up. Other half shows advanced remediation done by private owner (see paragraph 2.41).



Source: Environment Canada

this date. Work on the remaining 24 orphan sites will depend on provincial funding outside the National Contaminated Sites Remediation Program. Three of these remaining sites are large, and each will likely cost tens of millions of dollars to clean up.

2.43 Liability for clean-up will continue. Remediation strategies that contain the wastes on-site to prevent off-site migration of contaminants were used on several of the orphan sites. While risks to health and impacts to the environment may be reduced, containment strategies require long-term institutional controls, such as restricted access, ongoing treatment, maintenance and monitoring. In fact, the sites may eventually have to be remediated again as containment structures deteriorate over time. The costs of these controls will likely be borne by future generations. In addition, waste from some orphan sites was deposited in hazardous waste management facilities. These facilities already require long-term institutional controls and will eventually have to be properly decommissioned. It is evident that much work will be necessary in the years to come to complete the clean-up of known high-risk orphan sites in Canada.

2.44 The Department should raise with the Canadian Council of Ministers of the Environment the need for a national action plan to complete the clean-up of all remaining high-risk orphan sites in Canada as soon as possible.

2.45 Activity on potentially contaminated federal sites. The Department approved funding under the Program for the assessment of 326 federal sites held by seven government departments and one federal agency. As at 31 January 1995, about 90 percent of the assessments had been completed.

These assessments show that approximately half of the sites require immediate action or are likely to require remedial action in the near future. Other departments are responsible for providing further funding for any clean-up of these sites. Environment Canada's inventory indicates that only 326 of approximately 1,200 identified potential federal contaminated sites had been assessed by the end of the Program.

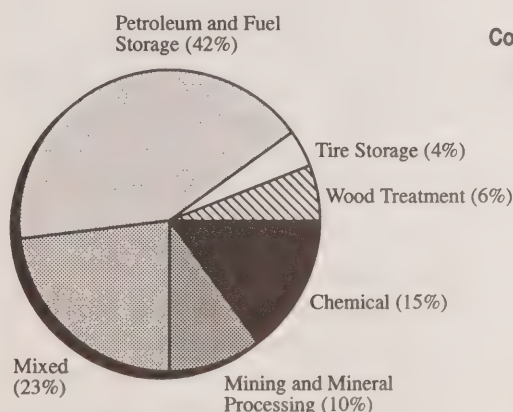
2.46 Up to 31 March 1995 the Department had also approved funding for the remediation of 18 federal orphan sites. Six of the 18 sites will likely require further work. However, there is no longer any funding for federal sites through the National Contaminated Sites Remediation Program.

2.47 Remediation technology development. By 1 September 1994, 45 projects had been approved under the Development and Demonstration of Site Remediation Technology component of the Program at a total federal cost of approximately \$11 million. Approximately 90 percent of these projects deal with soil remediation, a major concern at contaminated sites. Approved projects relate to the field-scale

Much work will be necessary in the years to come to complete the clean-up of high-risk orphan sites in Canada.

Exhibit 2.2

Major Sources of Contamination at Orphan Sites Approved under the NCSRP



Source: Environment Canada

Half of the federal sites assessed as of 31 January 1995 require immediate action or are likely to require remedial action in the near future.

There is no evidence that the Department plans to assess the impact that technology projects have had on the remediation industry.

demonstration of technologies, evaluation of the performance of technologies, and the development of methodologies and databases. This approach is consistent with program priorities and identified needs. DESRT-funded technologies were tested at 6 orphan sites. One of these technologies was subsequently used in the remediation process for some of the contamination. The other 5 technologies either showed inconclusive results or had not yet advanced to a commercial stage of development.

2.48 As of 31 January 1995, 14 projects were complete and technical reports were produced. Another 11 projects were to be completed by 31 March 1995. The remaining 20 projects will continue until 31 March 1997, but only 3 of these will require federal funding beyond 31 March 1995. The Department plans to assess technical reports arising from the remaining projects when they become available, and as resources permit. We saw no evidence that the Department plans to assess the impact that DESRT projects have had on the remediation industry or the impact it will have on the government's recently announced Strategy for the Canadian Environmental Industry.

2.49 The Department should evaluate the Development and Demonstration of Site Remediation Technology program as soon as possible and should incorporate the results into the government's Strategy for the Canadian Environmental Industry.

2.50 Development of scientific tools. The Department considers the development of a number of scientific tools as an important output of the NCSRP. Since 1991, development of a total of 12 scientific reference documents, methodologies and guidelines has been initiated by the Department to fill a

requirement for these tools. One of the tools developed is an ecological risk assessment methodology for contaminated soils. To date, this methodology has been applied to validate half of the clean-up criteria listed in the Interim Environmental Quality Criteria mentioned in paragraph 2.24. The Department anticipates that these new clean-up criteria will be published in the 1995-96 fiscal year and will provide objective standards that can be applied to the clean-up of contaminated sites. This may help resolve a long-standing issue — "How clean is clean?"

2.51 The Department should assess the scientific tools developed by the National Contaminated Sites Remediation Program and modify them as required to encourage their broad application.

Measuring and reporting results could be improved

2.52 Complete information on the National Contaminated Sites Remediation Program was not reported. In our 1991 Report, we recommended that the Department provide information in its Part IIIs on significant constraints to achieving the objectives of the Program and project only those results that could reasonably be achieved with the resources requested. We note that the Department has made a significant contribution to the CCME's annual reports to the public on the NCSRP. Since 1992-93, the Department has reported its planned expenditures for the national orphan sites component and a number of DESRT projects. However, it did not report actual expenditures, results achieved or likely achievable, or constraints to achieving program objectives. In its 1995-96 Part III, the Department reported that work would continue to complete projects already under way. However, we noted

that their operational plans for 1995–96 include funds for up to only 13 of the 37 remaining orphan sites approved for clean-up (see paragraph 2.60).

2.53 Use of program funds. To date, provinces have been slow to take up federal funds allocated to orphan sites. We were advised that this could be attributed partly to the nature of clean-up activities and partly to the lack of provincial funds to match the federal funds. Considerable time and effort may be required to identify and establish the source of contamination for each site, obtain the necessary environmental orders, perform the site assessments and determine a remediation strategy. For example, assessment and tests began in 1986 at Ville Mercier, Quebec, an orphan site with extensive groundwater contamination, and a remediation strategy is only now under public review. Remediation of a site can also be a long process. In the case of another orphan site involving groundwater contamination, a PCB waste transfer facility in Smithville, Ontario, remediation has been going on since 1985.

2.54 Parliament not fully informed on reallocation of NCSRP funds. The Department has to date spent approximately \$86.3 million, including approximately \$12 million for program administration, out of the total \$145.6 million approved for its portion of the National Contaminated Sites Remediation Program. The Department plans to spend \$8 million in 1995–96. Of the remaining \$51.3 million approximately: \$13.7 million was used to offset general budget cuts in other programs; \$14 million lapsed; and \$23.6 million was used in 1994–95 to fund other programs, including Phase II of the Great Lakes Action Plan and the North American Waterfowl Management

Program. Parliament has not been fully informed about this reallocation of NCSRP funds.

2.55 The Department should inform Parliament through its Part III of the Estimates of significant changes to the funding levels of major programs.

2.56 Potential for cost recovery. The bilateral agreements with the provinces provide for the recovery of NCSRP clean-up costs from the current or new owners of remediated sites. The provinces are responsible for ensuring that a mechanism is in place to recover clean-up costs. The Department has not estimated any amounts potentially recoverable.

2.57 The Department should ensure that federal expenditures on contaminated site clean-ups will be recovered where applicable.

2.58 Measuring and reporting progress. The Department has developed a methodology to measure the extent to which orphan sites have been cleaned up. The Department plans to use this methodology, after appropriate testing, to conduct “post-project” assessments on completed remediation projects in the 1995–96 fiscal year. These assessments will include an analysis of federal liability.

2.59 Cabinet and Parliament were not fully informed about federal liability for clean-up costs. When the National Contaminated Sites Remediation Program was approved in 1989, Cabinet required that Environment Canada, in collaboration with other participating government departments, report at the end of three years on the progress and the adequacy of funds for cleaning up federal sites. The 1993 study (see paragraph 2.37) indicated that there is significant federal liability for clean-up. However, the report to Cabinet was not produced. We have seen no evidence that either

The Department did not report actual expenditures, results achieved or likely achievable, or constraints to achieving the objectives of the clean-up program.

Parliament was not fully informed on reallocation of clean-up funds.

There is no evidence that either Cabinet or Parliament was ever fully apprised of the extent of federal liability for clean-up or the level of funding required for contaminated sites.

Environmental liability for clean-up of contaminated sites is far from resolved.

Cabinet or Parliament was ever fully apprised of the extent of federal liability for clean-up or the level of funding required.

The National Contaminated Sites Remediation Program is sunsetting, but the need for clean-up continues

2.60 Federal liability for orphan site clean-up costs needs to be clarified. The approval of new orphan sites, technology demonstration and federal sites projects was cut off on 1 September 1994, to ensure an orderly wind-up of the Program by 31 March 1995. Nevertheless, because of delays in getting approved projects started, the Department has included in its 1995–96 operational plans a provision of \$8 million to continue the clean-up of up to a further 13 orphan sites and 3 technology demonstration projects currently under way. The Department informed us that it has asked for legal advice on any residual federal liability beyond 1995–96 for clean-up costs for the remaining 37 sites approved under the bilateral agreements.

2.61 Clean-up liability has not been resolved. There are few legal precedents covering the determination of liability for contamination of lands. Furthermore, despite some progress in strengthening provincial legislative frameworks as referred to in paragraph 2.29, evidence indicates that the issue of environmental liability for clean-up is far from resolved. For example, lenders are seeking amendments to the *Bankruptcy and Insolvency Act* that would provide protection for trustees and receivers from liability for costs of environmental clean-up. We were advised by the Department that there were significant differences of opinion among stakeholders on some of the CCME's 13 principles for effective contaminated site remediation legislation. One such difference concerns

the principle of “joint and several liability”, which allows governments to pursue any one of the parties that have responsibility for a contaminated site for the cost of clean-up. An alternative involves the concept of an “orphan share”, which refers to a portion of the liability for contamination that has become the responsibility of governments. Acceptance of the orphan share concept would necessitate an ongoing orphan fund to pay for clean-up costs that can not be assigned to a responsible party. We understand that the CCME has discontinued discussions with industry, banking and environmental stakeholders on this topic. It seems unlikely, therefore, that national consensus on joint and several liability for clean-up will be obtained in the near future. The question “Who pays?” is a complex societal issue that is far from being resolved.

2.62 The Department should continue its analysis of provincial government and private sector activity in the identification and clean-up of contaminated sites as a basis for determining the adequacy of the national legislative framework.

2.63 The need for further action on federal sites. No plan was created for a cost-shared program for federal sites beyond 31 March 1995, because the \$25 million originally allocated for this component was expended on federal site assessments and clean-ups, the development of scientific tools and program administration. We noted that Environment Canada plans to continue to offer its technical expertise and advice on contaminated sites to other government departments after the National Contaminated Sites Remediation Program ends. As noted earlier, a number of federal sites remain to be assessed and remediated. Currently, Treasury Board

policy requires departments to assess sites only when they are subject to sale, transfer or change in use. This means that the most highly contaminated federal sites may not be cleaned up. Such an omission would impact negatively the government's promise in the Green Plan to lead by example.

2.64 The Department should consider the need for an action plan to complete the assessment and remediation of all federal contaminated sites.

The Storage and Destruction of PCBs

Policy and strategic direction are in place

2.65 Establishing the framework. Parliament passed the *Environmental Contaminants Act* in 1976 to control the use of toxic substances such as polychlorinated biphenyls (PCBs). Environment Canada introduced regulations to control PCBs under this Act in 1977, 1980 and 1985. Following the PCB spill in Kenora, Ontario, in 1985, Canada adopted the national PCB Action Plan developed by the Canadian Council of Ministers of the Environment.

2.66 After the fire in Saint-Basile-le-Grand, Quebec, in 1988, the federal government introduced an Interim Order under the new *Canadian Environmental Protection Act* (CEPA), which replaced the *Environmental Contaminants Act*, to control the storage of PCB wastes. At that time, the government announced its federal PCB Destruction Program. This program included the Department of National Defence's expenditure of \$6 million for a mobile incinerator at Goose Bay, Labrador, to destroy its PCBs and \$15 million for Environment Canada to locate, construct and operate a second

mobile incinerator unit on a federal site. Furthermore, under the Program, Environment Canada was to co-ordinate the destruction of low-level PCB-contaminated material in the federal inventory within one year.

2.67 In October 1989, the CCME announced a joint federal-provincial framework that involved phasing out the use of PCBs; shifting the emphasis from storage to destruction; establishing destruction sites based on community acceptance; and destroying PCBs within Canadian borders. Furthermore, the Minister of Environment accepted the recommendation of the Canadian Environmental Advisory Council in 1989 that the siting process be designed around the concerns of the public. In addition, the Green Plan (1990) confirmed the federal government's PCB Destruction Program commitment with a 1996 deadline for the complete destruction of federal PCB wastes.

2.68 Environment Canada's role in the management of PCBs. The Department provides the federal voice at CCME and federal leadership in the development and implementation of federal-provincial initiatives to regulate the use of PCBs and the storage and destruction of PCB wastes. The Department also spearheads the federal part of the national initiative by co-ordinating the activities of federal owners of PCBs and providing advice at both headquarters and regional levels on the storage, transportation and treatment of PCB wastes.

The PCB Management Program encompasses an inventory, a legislative framework and a timetable for destruction

2.69 A national PCB inventory exists. Since the first national inventory was published by the Canadian Council of

The Green Plan (1990) confirmed the federal government's commitment to destroy its PCB wastes by 1996.

PCB wastes totalling 127,025 tonnes are located at 3,216 sites across the country; this includes 495 federal sites containing 5,206 tonnes.

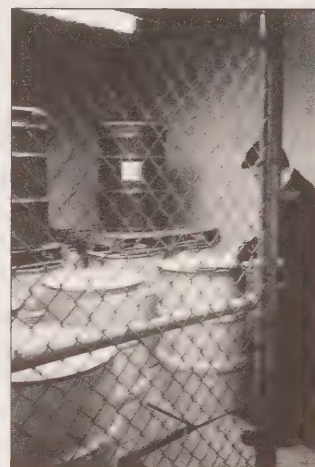
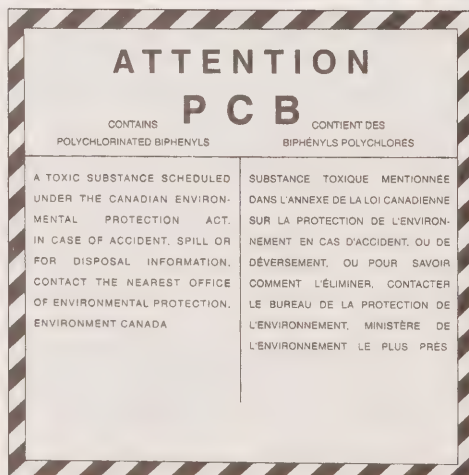
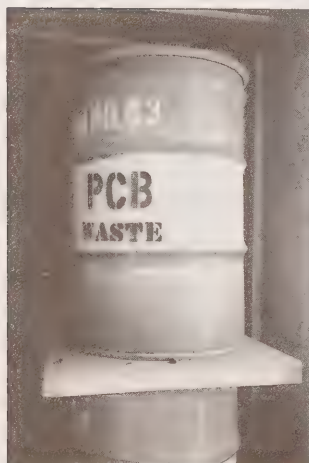
At the national level, annual PCB destruction has been significant, but PCB-related health and environmental risks remain.

Ministers of the Environment in 1988, it has been maintained by the Department using data from federal and provincial jurisdictions on PCBs in use and PCB wastes in storage. The 1993 CCME annual report indicates that there are more than 110,000 PCB-containing items in use or in storage at 6,000 locations across the country. PCB wastes are located at 3,216 sites across the country and total 127,025 tonnes; this includes 495 federal sites containing 5,206 tonnes.

2.70 At the national level, annual PCB destruction has been significant. Between 1988 and 1993, over 78,400 tonnes were incinerated or treated. A large volume of PCB waste, however, remains in storage, and more will be added as equipment containing PCBs, such as transformers, comes out of service. This means that PCB-related health and environmental risks remain.

Storage of PCB Wastes

A total of 495 federal sites contain 5,206 tonnes of PCB wastes. There are 97 tonnes of federal PCB wastes stored in 237 small sites (see paragraphs 2.69 and 2.70).



Source: Environment Canada

2.71 The regulatory framework.

The *Canadian Environmental Protection Act* authorizes the Department to regulate all aspects of the life cycle of toxic substances, including PCBs. This is accomplished for PCBs through the Federal Mobile PCB Treatment and Destruction Regulations (1990); PCB Waste Export Regulations (1990); Chlorobiphenyl (PCBs in use) Regulations (1991); and Storage of PCB Material Regulations (1992). New regulations that have been proposed to replace the

Chlorobiphenyl Regulations in 1995 will require reporting on in-use equipment containing PCBs and phasing out by 1997 of this equipment in sensitive locations, such as schools and hospitals. National enforcement statistics for the period 1991-92 to 1994-95 are shown in Exhibit 2.3.

2.72 The Department has arrangements with provinces to ensure a uniform national approach to the enforcement of PCB regulations. For

Exhibit 2.3

Enforcement Action¹ and Compliance Levels² for PCB Regulations and Ocean Disposal Regulations for the Period 1991-92 to 1994-95

CEPA Regulations	Enforcement Action/Compliance	Fiscal Year			
		1991-92	1992-93	1993-94	1994-95 (April-June)
Storage of PCB Material Regulations	# inspections	240	281	417	128
	# warnings	44	30	71	14
	# investigations	3	5	16	0
	% compliance	81	88	79	89
Chlorobiphenyl Regulations (for PCBs in use)	# inspections	414	228	296	56
	# warnings	10	2	13	0
	# investigations	31	19	3	3
	% compliance	90	91	95	95
PCB Waste Export Regulations	# inspections	21	7	13	0
	# warnings	4	0	2	0
	# investigations	0	0	1	0
	% compliance	81	100	77	n/a
Mobile PCB Treatment and Destruction Regulations	# inspections	6	4	5	2
	# warnings	0	1	0	0
	# investigations	2	0	0	0
	% compliance	66	75	100	100
Ocean Dumping Regulations	# inspections	100	116	55	27
	# warnings	8	3	5	0
	# investigations	11	5	10	1
	% compliance	81	93	73	96

1. Based on information received from Office of Enforcement, Environment Canada

2. Calculation: $\frac{\text{No. of inspections} - (\text{No. of warnings} + \text{No. of investigations})}{\text{No. of inspections}} \times 100$

Source: Environment Canada

example, it has agreements with Nova Scotia and Newfoundland to co-operate on the administration of PCB storage regulations. However, the Department has not yet signed any agreements with provinces, as provided for in CEPA, that would recognize the equivalency of federal and provincial PCB regulations. Until such equivalency agreements are finalized, the potential exists for federal-provincial overlap in both regulation and enforcement.

The PCB Destruction Program has stalled

2.73 Environment Canada's management of federal PCBs. The Department's regions have paid considerable attention to the enforcement of PCB regulations. In the period 1991-92 to 1993-94, over 40 percent of all inspections under the Act were devoted to these regulations. We found that while the Department has compiled data nationally on the numbers of inspections, warnings and investigations, it has provided no calculation of the extent of compliance with the regulations by the

owners of PCBs. However, the Department is currently analyzing in detail national compliance with a sample of regulations, including those for PCB storage. This will enable it to report in the future on national compliance levels and trends.

2.74 Progress on destruction of PCB wastes. There are two approved methods for the destruction of PCB wastes — thermal (high-temperature incineration) for high concentrations of PCBs (over 40 percent) and chemical (decontamination) for lower PCB concentrations. The incineration of 33,618 tonnes of high-level PCB wastes in Canada has occurred to date at four sites: the only permanent incineration facility at Swan Hills, Alberta; the temporary DND facility at Goose Bay, Labrador; the Ontario government's temporary facility at Smithville, Ontario; and a temporary facility in Baie-Comeau, Quebec. Since 1983, low-level PCBs have been and continue to be successfully treated across Canada.

2.75 The Federal PCB Destruction Program. The Department controls the

Exhibit 2.4

Status of Funds (\$000s) Allocated to the Federal PCB Destruction Program

Fiscal Year	Expenditures		Lapses of Funds	Reallocations of Funds	Budget Cuts	Total
	Headquarters	Regions				
1989-90	1,778.5		81.5			1,860.0
1990-91	268.0	250.8	1.4			520.2
1991-92	692.7	399.3	57.0		400.0	1,549.0
1992-93	272.1	569.6	122.5	1,400.0	1,042.1	3,406.3
1993-94	621.5	1,612.1	90.7			2,324.3
1994-95*	42.0	858.0	3,440.2	1,000.0		5,340.2
Grand Total						15,000.0

* Estimated as of 17 March 1995

Source: Environment Canada

\$15 million funding for the Federal PCB Destruction Program and allocates funds to its regions to carry out site selection processes for mobile incinerators. These funds were to be used for site selection, environmental assessment, public information and consultation, and commissioning, operation and decommissioning of additional mobile destruction sites in Canada. Over \$3.6 million of these funds, allocated as shown in Exhibits 2.4 and 2.5, were used by the regions for the site selection process. Efforts were focussed in Atlantic Canada, Quebec and Ontario. However, only in the latter province does the process still have some likelihood of success. In view of this, the Department advised us that it is now considering the use of the facility at Swan Hills, Alberta for the destruction of federal high-level PCB wastes.

2.76 Atlantic Canada. One site in Nova Scotia and one in New Brunswick were selected, and both were subjected to an environmental assessment. The Independent Review Committee conducted public hearings in its review of the assessment. The Committee concluded that while both sites were acceptable on technical grounds, they were unacceptable to the communities

affected. As a result, the site selection process has been terminated.

2.77 Quebec. The aggregation of federal and provincial wastes was proposed to make a destruction facility more cost-effective. Three sites were originally selected by the Province — Saint-Basile-le-Grand, Baie-Comeau and Shawinigan — for the destruction of federal and provincial PCB wastes. Attention was ultimately focussed on the Shawinigan location. However, public hearings concluded that although the site was technically suitable, it was not acceptable to the public. Quebec has stated its intention to proceed on its own to destroy some of its inventory, beginning in Baie-Comeau, at a projected cost of \$30 million.

2.78 London, Ontario. Two candidate sites in London were identified. In the final phase of the selection process, the host communities for each site will be asked to indicate their support for the site(s) in a public vote this spring.

The PCB Destruction Program is sunseting without a comprehensive plan for the future

2.79 The current program will sunset on 31 March 1995. Depending on the final outcome of the Ontario site selection

Since 1983, low-level PCBs have been and continue to be successfully treated across Canada.

The Department is now considering the use of the facility at Swan Hills, Alberta for the destruction of federal high-level PCB wastes.

Exhibit 2.5

Allocation of Program Funds (\$000s) to Facility Siting Processes in Ontario, Quebec and Atlantic Canada

Fiscal Year	Ontario	Quebec	Atlantic Canada
1990-91	128.2	0	122.6
1991-92	103.3	117.0	179.0
1992-93	209.1	100.0	260.5
1993-94	255.3	297.0	1,059.8
1994-95*	209.4	230.0	418.6
TOTALS	905.3	744.0	2,040.5

* Estimated as of 17 March 1995

Source: Environment Canada

There is danger that momentum will be lost without the Department's continued co-ordination of the federal PCB destruction effort.

The Department has not determined the resources that will be needed beyond 31 March 1995 to complete the destruction of federal PCBs.

process, a second site for a mobile incinerator may be found. However, if this occurs, new funding will be needed after 1 April 1995 for commissioning, operating and decommissioning the facility.

2.80 Progress is being made. Even if the siting process has been unsuccessful, it has yielded positive results. The PCB Destruction Program provided for an interdepartmental focus for action on PCBs beyond the enforcement of CEPA regulations, that is, to co-ordinate federal activities, exchange information and promote action. The Department's regional offices promoted site selection activities, encouraged federal action to consolidate PCB wastes into larger storage sites and promoted their volume reduction. As a result, the number of federal sites has decreased from 593 in 1991 to the present 495. While consolidation of wastes is occurring, even more could be done. For example, the portion of federal PCB wastes (97 tonnes) that are presently stored in 237 small sites, each requiring full compliance with the PCB storage regulations, could be further concentrated.

2.81 Studies of destruction options (for example, use of the Swan Hills permanent facility or the possible use of facilities in the United States) and associated costs and risk assessments of transportation of PCB wastes have been made by the regional offices. Nevertheless, there is a real danger that this momentum will be lost without the Department's continued co-ordination of the federal effort.

2.82 The Department should continue to assist federal departments to treat low-level PCB contaminated mineral oils; consolidate PCB wastes into larger storage sites that can be better managed; and reduce the volume

of waste to be destroyed by removing PCBs and recycling usable components.

Next steps required are an evaluation of achievements and provision for continued leadership

2.83 An evaluation of progress is necessary. In its Part III of the 1994-95 Estimates, the Department committed itself to the Green Plan's 1996 deadline for the destruction of all federal PCBs. However, this deadline is not realistic, given that some equipment containing PCBs will remain in use for the foreseeable future, and that arrangements for the destruction of federal PCBs across the country are far from complete. Furthermore, the termination on 31 March 1995 of funding to assist federal departments in meeting the Green Plan deadline puts this target further in jeopardy. Finally, the Department has not evaluated achievements to date, accounted for funds expended under the PCB Destruction Program, or determined the resources that will be needed beyond 31 March 1995 to complete the destruction of federal PCBs. Without such information, the operational and financial planning on an interdepartmental basis required to achieve the federal PCBs destruction goal will be at best delayed or, at worst, halted. This could compromise the 1994 Canada-Ontario Agreement that includes a commitment to destroy 50 percent of high-level PCB wastes stored in Ontario by 2000.

2.84 In view of continuing public concern about the siting of PCB destruction facilities, the Department should report to Parliament on progress made to date on PCB destruction, providing a realistic assessment of the risks associated with long-term storage and the costs and time needed to destroy the total federal inventory.

2.85 Management of PCBs is costly.

Continuing federal storage, consolidation and destruction activities will require significant financial commitments by departments. While we have been able to gather only limited data on these costs (Exhibit 2.6), the Department's studies have given some indication of their magnitude. For example, to transport the 1,326 tonnes of federal PCB waste in Quebec (approximately 23 percent of the federal inventory) to the facility at Swan Hills, Alberta and destroy it would cost approximately \$4 million.

2.86 The Department should continue its leadership and co-ordinating role in assisting departments to dispose of their PCB wastes in a safe and cost-effective manner.

The Management of Ocean Disposal

2.87 In 1972, Canada signed the London Convention to promote the effective control of marine pollution. Since then, the Department has been regulating ocean disposal, initially through the *Ocean Dumping Control Act*, repealed in 1988, and subsequently under Part VI of the *Canadian Environmental Protection Act* and the Ocean Dumping Regulations. In September 1994, CEPA and the Ocean Dumping Regulations were amended to bring them into line with revisions to the London Convention, which banned sea disposal of radioactive and industrial waste, and the incineration at sea of the latter.

2.88 Between 1983 and 1993, Environment Canada issued an average of 176 permits annually for disposal at approved ocean sites (Exhibit 2.7). Types of material approved for disposal over that period were dredged material, fish waste,

excavation material and construction rubble, vessels and scrap metal. However, the number of permits issued for fish waste is declining, likely as a result of a moratorium on cod and capelin fishing in Atlantic Canada. National enforcement statistics for the period 1991–92 to 1994–95 are shown in Exhibit 2.3.

2.89 In our 1990 Report, we stated our satisfaction with the Department's 1989 evaluation of its ocean disposal program and concurred with the criticism in the evaluation report of the scientific support to the program. In 1991, under the Green Plan, the Department responded by developing the six-year \$10 million Ocean Dumping Control Action Plan to improve regulations, develop new disposal site monitoring guidelines and reduce persistent plastics in our coastal waters. The implementation of this Action Plan is on schedule.

Conclusion

2.90 Due to past management practices related to wastes and other materials, such as automotive fuels, and ignorance of the dangers of certain synthetic substances, the federal government and provincial governments have inherited a legacy of contaminated sites to remediate and a quantity of PCB wastes that they must now either destroy or store safely to minimize risks to human health and the environment. Federal government goals and deadlines established to deal with these issues have proved to be unrealistic. As a result, contaminated sites will continue to pose a threat to human health and the environment. In view of the limited success of the federal PCB Destruction Program and the difficulties of siting mobile destruction facilities, the federal government's proposal to consider using

The implementation of the Ocean Dumping Control Action Plan is on schedule.

Canadian governments have inherited a legacy of contaminated sites to remediate and a quantity of PCB wastes that must be either destroyed or safely stored.

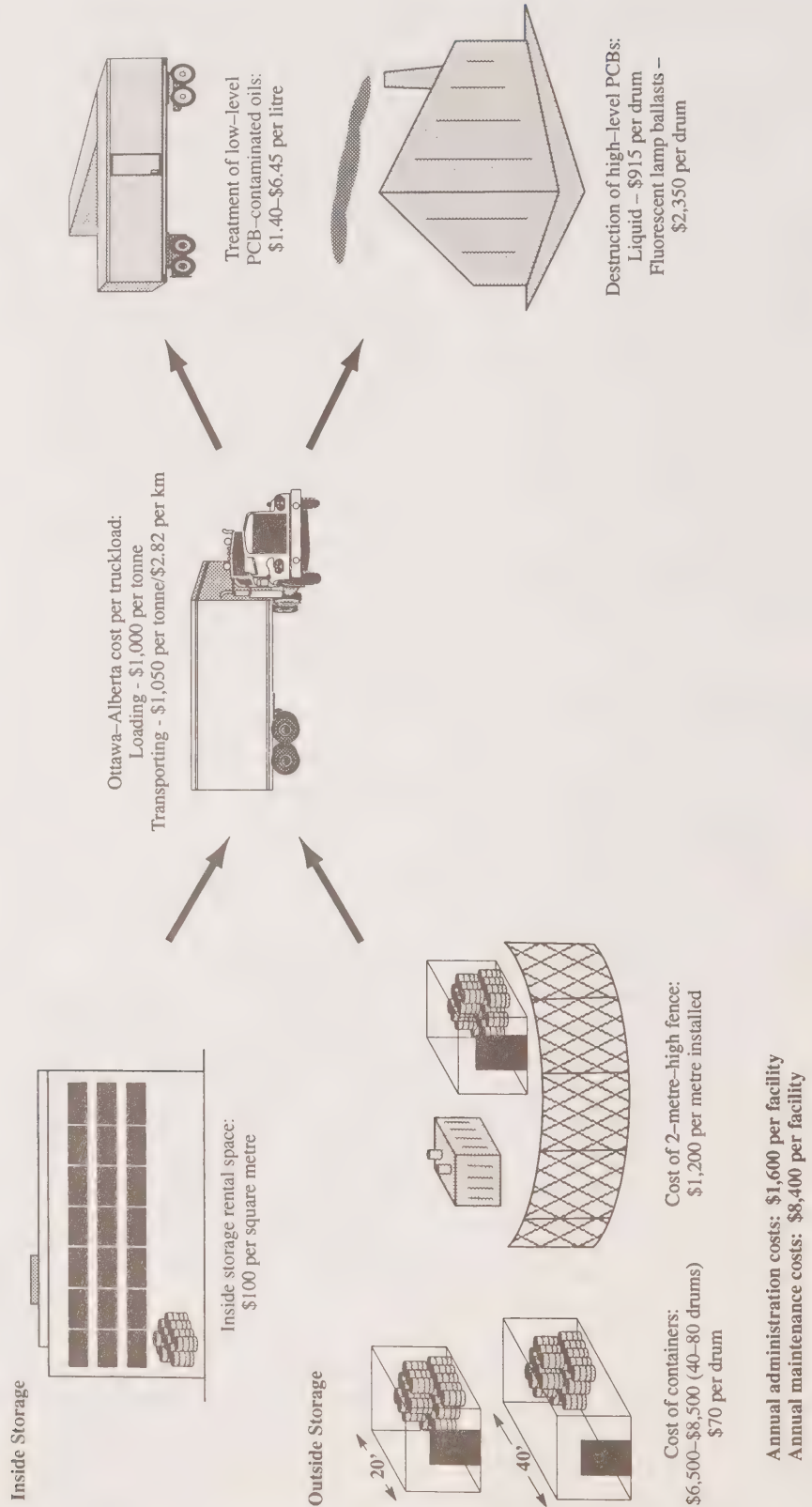
Exhibit 2.6

Typical Costs Associated with the Storage,
Transportation, Treatment and Destruction of PCB Wastes

TREATMENT/DESTRUCTION
(average \$4,500 per tonne)

TRANSPORTATION
(average \$800-\$1,100 per tonne)

STORAGE
(average \$600 - \$800 per tonne)



the facility at Swan Hills, Alberta may prove to be too restrictive.

To date, the Department has not conducted an analysis of the potential consequences to present and future generations of terminating the National Contaminated Sites Remediation Program and the PCB Destruction Program. Such information would be important to Parliament in assessing any request for funds for dealing with the legacy of hazardous wastes.

Department's response: *Both the National Contaminated Sites Remediation and PCB Destruction programs were partnership initiatives aimed at stimulating action by others, namely, the*

provinces, other federal government departments, and industry. There were many successes (e.g. in providing a catalyst to the remediation industry sector) and significant contributions that will continue to have a positive effect on these issues: development of inventories, scientific tools, technology and the legislative frameworks in most provinces. In carrying out these programs, we have learned that it is difficult to set initial targets when the results depend on actions taken through federal-provincial partnerships and when public consultation and social values are essential elements in choosing a site for PCB destruction facilities.

Although these programs have been sunsetted, the Department will continue to

Federal government goals and deadlines established to deal with contaminated sites and PCB wastes have proved to be unrealistic.

Exhibit 2.7

Ocean Disposal: Permits Issued and Quantities of Dredged Material and Fish Waste Approved for Disposal, 1983 to 1993

Year	Permits Issued			Quantities Approved for Disposal		
	Total Number	% Issued for Dredging	% Issued for Fish Waste	Total Tonnes (thousands)	% Dredged Material	% Fish Waste
1983	134	85.8	3.7	8,412	99.9	0.1
1984	139	82.7	2.2	8,210	99.9	0.1
1985	161	76.4	7.5	8,043	99.5	0.5
1986	168	75.6	3.6	8,227	99.7	0.1
1987	168	73.9	16.4	7,281	94.8	3.1
1988	159	79.9	10.1	8,286	90.5	1.8
1989	177	61.6	27.1	7,605	86.8	1.7
1990	200	38.5	51.0	8,743	70.9	1.9
1991	222	39.6	55.9	6,902	81.1	2.1
1992	219	37.9	55.3	7,094	91.6	1.4
1993	195	34.7	48.9	7,201	89.1	1.1
Average	176	62.4	25.6	7,818	91.2	1.3

Source: Environment Canada

play an active role in encouraging action and monitoring progress, as resources permit. The Department will reallocate \$7.8 million from its 1995–96 A-Base to assist the provinces in completing the remediation of selected high-priority

outstanding orphan sites. Work will continue, on a priority basis, with other government departments to transfer PCBs and destroy them at the Swan Hills Facility in Alberta.

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Report of the Auditor General of Canada to the House of Commons

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 3
Federal Radioactive Waste Management

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

**Chapter 3
Federal Radioactive Waste Management**



May 1995

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Chapter 3

Federal Radioactive Waste Management

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Federal Radioactive Waste Management

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Main Points

- 3.1** The federal government has a significant role in developing overall policy and federal strategy for radioactive waste management. It has jurisdiction over, and regulatory responsibility for, nuclear energy, including radioactive waste. The government also conducts research on radioactive waste and is an owner of some of this waste.
- 3.2** Radioactive waste management involves the handling and treating of radioactive waste, as well as its transportation, storage and disposal. Storage involves managing radioactive material in a safe manner with provision for retrieval. Disposal refers to permanent placement of radioactive waste with no intention of retrieval.
- 3.3** Federal regulatory policy states that the objectives of radioactive waste disposal are to minimize any burden placed on future generations, to protect the environment and to protect human health. Radioactive waste is generally managed in facilities licensed by the Atomic Energy Control Board (AECB), which provides assurance that the waste is stored in a safe manner. The AECB considers that the current management of the waste is only an interim measure and that long-term solutions are required to ensure long-term safety. Canada has no disposal facilities for any of its high-level or low-level radioactive waste.
- 3.4** Since the early 1950s, Atomic Energy of Canada Limited (AECL) has carried out research on the disposal of high-level radioactive waste, primarily used fuel from nuclear reactors. A major research and development program was initiated in 1978 to find a solution for disposal of this waste. Throughout the program, Canada's target dates for having an operational disposal facility have continually been extended, with 2025 being the current target date for such a facility. Moreover, Canada's program has not kept pace with some other countries. For example, Sweden, which is developing a similar concept, plans to have an operating repository by 2008. Decisions still have to be taken in Canada on whether and how to proceed to a disposal solution. Despite the significant investment, in Canada, of about \$538 million in research and development, there has been no consideration of alternative approaches for moving Canada's high-level radioactive waste program forward after March 1997, when current federal funding ends.
- 3.5** Low-level radioactive waste from ongoing operations of the Canadian nuclear industry is currently stored in AECB-licensed facilities, but a plan needs to be developed for its disposal. Unlike some other countries, Canada does not have an approved disposal technology or any disposal sites or facilities for this operational waste.
- 3.6** Historic wastes are another type of low-level radioactive waste. They are the responsibility of the federal government and are currently being monitored and managed as an interim measure to protect public health and the environment. Various federal initiatives have been undertaken to find long-term solutions. In particular, once the current Siting Task Force presents its report, decisions will be required by the government on implementing long-term solutions for the Port Hope area historic wastes.
- 3.7** Uranium tailings, another class of radioactive waste, fall under federal and provincial regulations. The AECB chose not to license uranium mines that had ceased operations prior to 1976. As a result, these pre-1976 sites have not been subjected to the AECB's current regulatory regime and need to be brought under its regulatory control. The federal and provincial governments need to assign residual responsibilities for the rehabilitation and decommissioning of uranium tailings sites in Ontario and Saskatchewan and for the provision of their long-term institutional care.

Main Points (cont'd)

3.8 The federal share, over the next 70 years, for implementation of disposal solutions for Canada's radioactive waste is approximately \$850 million of the at least \$10 billion that is the responsibility of Canadian waste producers, in particular the nuclear utilities. The federal share will increase if the government has to assume residual responsibilities for any of the waste producers. To date, none of the potential liabilities have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada.

3.9 To minimize future federal liabilities and the burden on future generations, Canada must now translate its technical knowledge into implementation of long-term, cost-effective solutions for its radioactive waste. It is also important to ensure that funding arrangements are in place to meet the financial requirements of future solutions. The federal government has an important role to play in making the transition to long-term solutions for used fuel and low-level radioactive waste. In addition to providing policy direction, Natural Resources Canada should work toward establishing an agreement among the major stakeholders on their respective roles and responsibilities and the approaches and plans for implementing solutions.

Introduction

3.10 The term “radioactive waste” covers everything from highly radioactive used reactor fuel to slightly radioactive contaminated clothes from workers at nuclear facilities. The type of radioactive waste is generally determined by its level of radioactivity and by the length of time the material needs to be kept isolated from people and the environment. The federal government groups radioactive wastes into three broad administrative classes: high-level waste (HLW), low-level waste (LLW) and uranium tailings. Different solutions are required for these three waste classes.

3.11 In Canada, HLW normally refers to used fuel that has been discharged from nuclear reactors. Used fuel is sometimes referred to as “nuclear fuel waste”. Used fuel remains highly radioactive for at least 500 years, and handling it requires appropriate measures for ensuring protection of humans and the environment over this period. In fact, some elements of used fuel remain hazardous for tens of thousands of years if they escape containment and are then ingested or inhaled.

3.12 There are two types of LLW, historic waste and operational waste. The majority of the existing volume of LLW is historic waste, for which the original producer or owner can no longer reasonably be held responsible. Historic wastes were managed in a manner no longer considered acceptable. This waste generally remains hazardous for over 500 years, since much of the waste contains radium and uranium refinery waste.

3.13 Most operational LLW decays to non-hazardous levels in less than 500 years. The following are examples of operational LLW:

- non-fuel waste from the ongoing activities of Canada’s 22 operating nuclear power reactors and from radioactive waste produced by fuel processing and fabrication facilities, as well as from the medical, research and industrial communities; and
- radioactive waste from the decommissioning of nuclear facilities when the facilities are retired permanently at the end of their service or operational life.

Non-fuel waste includes used radioisotopes from hospitals and laboratories and contaminated used equipment, materials, cleaning rags and protective clothing.

3.14 Uranium tailings are radioactive waste generated during the mining and milling of uranium ore. In addition to radioactive substances, uranium tailings often contain hazardous chemicals. These tailings may cause health problems if not properly contained and controlled. Although the radioactive material in uranium tailings occurs naturally, the potential for radiation exposure increases when uranium ore is brought to the surface. Most of this radioactive material will pose a radiological hazard for tens of thousands of years, and some of the hazardous chemicals, such as arsenic, will last indefinitely.

3.15 A radioactive gas, radon, will continue to be released into the atmosphere from poorly designed or maintained uranium tailings sites. Radon gas from the tailings is a concern if people reside close to the site or if tailings are used in construction. In addition, uranium tailings, like other mine tailings, may contain materials such as acid-producing rock, which can create environmental and health risks from acid seepage.

3.16 Radioactive waste management comprises all of the planning,

Radioactive waste management involves the handling and treating of radioactive waste, as well as its transportation, storage and disposal.

Federal responsibility for managing Canada's radioactive waste and resolving the related issues is divided among many players.

administrative and operational activities that are involved in the handling and treating of radioactive waste, as well as its transportation, storage and disposal.

3.17 Storage involves managing radioactive material in a safe manner with provision for retrieval. Active institutional controls are required to monitor and maintain the storage facility and to control access to ensure safety.

3.18 Disposal refers to permanent placement of radioactive waste with no intention of retrieval. Ideally, disposal involves techniques and designs that do not rely for their success on long-term institutional controls beyond a "reasonable period of time".

3.19 Choosing long-term solutions for managing radioactive waste hinges on finding cost-effective ways to protect

people and the natural environment from the material and to prevent accidental access to or use of the material. The chosen solutions may be either monitored long-term storage or disposal.

Responsibilities for Radioactive Waste Management

3.20 Federal responsibility for managing Canada's radioactive waste and resolving the issues related to high-level and low-level radioactive waste and uranium tailings is divided among many players. Exhibit 3.1 illustrates the key federal responsibilities as they pertain to this audit.

3.21 Besides federal departments and agencies, other entities are involved in the management of Canada's radioactive

Exhibit 3.1

Summary of Key Federal Responsibilities (as they pertain to this audit)

NATURAL RESOURCES CANADA (NRCan)

- develops federal policies and strategies;
- conducts research related to uranium tailings; and
- negotiates with the provinces on long-term radioactive waste management issues.

SITING TASK FORCE (ONTARIO)

- identifies possible sites for historic low-level radioactive waste from the Port Hope and Scarborough areas (funded by NRCan).

ATOMIC ENERGY CONTROL BOARD (AECB)

- regulates the nuclear industry.

ATOMIC ENERGY OF CANADA LIMITED (AECL)

- operates a commercial low-level waste (LLW) storage facility; and
- conducts research into storage and disposal.

LOW-LEVEL RADIOACTIVE WASTE MANAGEMENT OFFICE

- resolves historic waste problems; and
- establishes a user-pay service for disposal of LLW.

FEDERAL ENVIRONMENTAL ASSESSMENT AND REVIEW OFFICE, recently replaced by the Canadian Environmental Assessment Agency

- administers the federal "Environmental Assessment and Review Process Guidelines Order" (1984), replaced by the *Canadian Environmental Assessment Act* of 1995.

waste. These include the electrical utilities that operate nuclear power reactors, uranium mining companies and the provincial ministries responsible for the environment, health, labour and mines.

3.22 The *Atomic Energy Control (AEC) Act* gave the Atomic Energy Control Board (AECB) responsibility in 1946 for the regulation of the nuclear industry in Canada. In 1988, following federal-provincial discussions concerning the sharing of jurisdictions for certain types of radioactive materials, the *AEC Regulations* were amended to clarify existing practices. The amendment excluded any naturally occurring radioactive material not related to the development, application or use of nuclear energy. Therefore, many radioactive industrial materials are not covered by the current *AEC Regulations*. These materials include, for example, incidental wastes from phosphate fertilizer producers, and pipe scales and sludges from oil and gas exploration.

3.23 Despite the fact that incidental wastes are now excluded from AECB regulatory control, some of them still require special handling, storage and disposal methods, similar to those used for historic wastes. The AECB considers that regulatory responsibility for incidental wastes rests with the provincial and territorial governments. We have been advised by Natural Resources Canada that some of the provinces are now moving toward the development of formal guidelines on the control of incidental wastes.

Radioactive Waste Management Is a Significant Federal Issue

3.24 Under the *Atomic Energy Control Act*, the AECB has had responsibility for the control and supervision of the development, application and use of nuclear energy since 1946. The AECB's regulatory activities cover all aspects of the nuclear fuel cycle. This cycle includes the mining, milling and refining of uranium, the generation of nuclear power, the production and use of radioisotopes and the management of radioactive waste.

3.25 The federal government and the province of Ontario have a long history of working together in the development of the nuclear industry. Atomic Energy of Canada Limited (AECL), the federal Crown corporation that designed Canada's nuclear power reactors, has worked closely with Ontario Hydro since the early 1950s. This partnership supported the development of the CANDU technology and the construction and operation of the first Canadian nuclear power reactors.

The Federal Government Has Its Own Radioactive Waste to Manage

3.26 The federal approach to radioactive waste management is based on the concept that the producer of the waste is responsible for its management. This concept is commonly referred to as "producer pays". However, situations exist where the original producer of the waste, or the current owner, can no longer reasonably be held responsible, or is unable or unwilling to pay. In some of

In some situations, the federal government has assumed "residual responsibility" for radioactive waste, as manager of last resort.

The current management of radioactive waste in AECB-licensed facilities is considered to be only an interim measure, with long-term solutions required.

The generations that receive the primary benefits of the current use of nuclear energy should bear the responsibility for managing the resulting waste.

these situations, the federal government has assumed “residual responsibility” for the waste, as manager of last resort. For example, the federal government has accepted responsibility for disposal of about one million cubic metres of historic wastes, in the form of contaminated soil, in the Port Hope and Scarborough areas of Ontario.

3.27 AECL owns some HLW, historic wastes and operational LLW for which it must find long-term solutions.

The AECB Provides Assurance That Radioactive Waste in Licensed Facilities Is Stored in a Safe Manner

3.28 Radioactive waste in Canada is generally managed in AECB-licensed facilities in a manner based on the principles of containment and isolation from people and the environment. Through its licensing and inspection system, the AECB provides assurance that its regulatory requirements are being met and that the radioactive waste in licensed facilities does not pose undue risk to health, safety, security and the environment.

3.29 There are 21 AECB licences currently in effect, covering 27 major waste management storage sites in Canada. The AECB has also issued about 3,700 licences to users of prescribed substances and radioisotopes in the medical, research and industrial communities, many of which possess radioactive waste. Although providing safe storage today in facilities that it has licensed, the AECB regards the current management of the waste as an interim measure, with long-term solutions required to ensure long-term safety.

Long-Term, Cost-Effective Solutions Need to Be Found

3.30 A regulatory policy of the AECB states that, taking into account social and economic factors, the objectives of radioactive waste disposal are:

- to minimize any burden placed on future generations,
- to protect the environment, and
- to protect human health.

3.31 According to these objectives, the generations that receive the primary benefits of the current use of nuclear energy should bear the responsibility for managing the resulting waste. Thus the present generation would need to develop the technology and construct and operate facilities for long-term solutions, and also arrange funding to implement the solutions. The present generation would be responsible for ensuring that mechanisms and funding are in place to provide sufficient controls over containment and isolation of the waste from people and the environment.

3.32 According to AECB regulatory policy, the preferred option for long-term management of radioactive waste is disposal. However, long-term storage is a viable option that the regulator is prepared to consider for some radioactive waste. In either case, long-term, cost-effective solutions are required.

3.33 Finding such solutions has proved to be a difficult, lengthy process that poses technical, social and economic challenges. Canada’s environmental assessment and review process requires broadly based consultation with the stakeholders as part of the decision-making process. The review process must also deal with public concern about the location of a waste disposal facility, a problem commonly referred to as the “not in my back yard” syndrome.

3.34 As yet, there is no decision in Canada on how to accomplish the transition from storage to disposal, how quickly to make the transition and whether long-term storage is acceptable in some cases. Canada has no disposal facilities for any of its high-level or low-level radioactive waste.

Radioactive Waste Management Issues Have Previously Been Brought to Parliament's Attention

3.35 There are many complex issues related to radioactive waste management in Canada. These issues have resulted in a considerable amount of study, with only very slow movement toward long-term solutions. Many of these issues have been brought to Parliament's attention by parliamentary committees, prior audit work of this Office and other sources, as shown in Exhibit 3.2.

Audit Scope, Objectives and Criteria

Audit Scope

3.36 In our 1994 chapter on the AECB, we noted that many players were involved in dealing with nuclear (radioactive) waste. In that chapter, we indicated our intention to audit further the broader issue of federal management of radioactive waste. This chapter reports the results of our audit work in this area. Chapter 2 in this Report deals with Environment Canada's management of other hazardous wastes.

3.37 We reviewed the federal government's discharge of its responsibilities for dealing with high-level and low-level radioactive waste and uranium tailings. The review included federal initiatives to find long-term solutions for existing radioactive waste, as well as for radioactive waste produced through ongoing operations. The

Canada has no disposal facilities for any of its high-level or low-level radioactive waste.

1977	Bill C-14 on a revised <i>Atomic Energy Control Act</i> , including financial assurances, did not pass.
1978	The Standing Committee on National Resources and Public Works studied the issue of Canada's management of nuclear waste, including the report commissioned by the Department of Energy, Mines and Resources entitled <i>The Management of Canada's Nuclear Wastes</i> .
1985	The Auditor General's Report noted that radioactive waste management was a growing and long-standing problem.
1988	The Standing Committee on Energy, Mines and Resources recommended that the schedule for establishing a high-level waste repository be advanced. (No government response was given.)
1988	The Standing Committee on Environment and Forestry concluded that deep geological disposal of nuclear fuel waste was an appropriate approach for Canada. (The government accepted most of the recommendations.)
1994	The Auditor General's Report noted that the <i>Atomic Energy Control Act</i> does not give the Atomic Energy Control Board explicit authority to require financial assurances.
1994	The Standing Committee on Natural Resources recommended establishment of a national database on active and orphaned mining sites and on reclamation work that must be undertaken.

Exhibit 3.2

Radioactive Waste Management Issues Previously Brought to Parliament's Attention

responsibilities of the federal departments and agencies involved are summarized in Exhibit 3.1.

3.38 We did not audit the management of incidental waste or the day-to-day operations of AECL's radioactive waste management facilities. We also did not conduct a technical review of Canada's research and development programs related to radioactive waste.

3.39 The quantitative information in this chapter has been drawn from the various government sources indicated in the text. Although this quantitative information has been checked for reasonableness, it has not been audited.

Audit Objectives

3.40 The objectives of our audit of the federal management of radioactive waste were:

- to assess whether the duties related to responsible management have been clearly defined and assigned;
- to report on all federal government initiatives undertaken and the costs incurred to date; and
- to assess the progress made by Canada.

Audit Criteria

3.41 The following general audit criteria were used:

- Roles and responsibilities should be clearly assigned for dealing with radioactive waste in Canada.
- The federal government should identify the problems of managing used fuel, low-level radioactive waste (LLW) and uranium tailings in Canada, develop a strategy for their management and ensure that plans and budgets are in place to address their management, including their disposal.

- Appropriate and timely action should be initiated by the federal government to deal with all classes of radioactive waste in Canada.

- Federal initiatives dealing with radioactive waste in Canada should be cost-effective and should include reporting to Parliament on the costs and results of these initiatives.

- The government should protect the federal taxpayer from potential liabilities as a result of radioactive waste.

- Any issues that remain unresolved in finding a long-term solution to radioactive waste should be disclosed to Parliament.

Observations on High-Level Radioactive Waste (HLW)

HLW is safely stored at reactor sites

3.42 When used fuel is removed from a reactor, it generates high levels of heat and is highly radioactive. As a result, the used fuel requires cooling and shielding. This is accomplished by storing it in water-filled pools at the reactor sites. After about five years, the reduction in heat output and in the level of radioactivity allows the used fuel to be placed in a dry storage system using concrete canisters. Current research indicates that both types of AECB-licensed storage facilities, if properly maintained, are expected to last for at least 50 years.

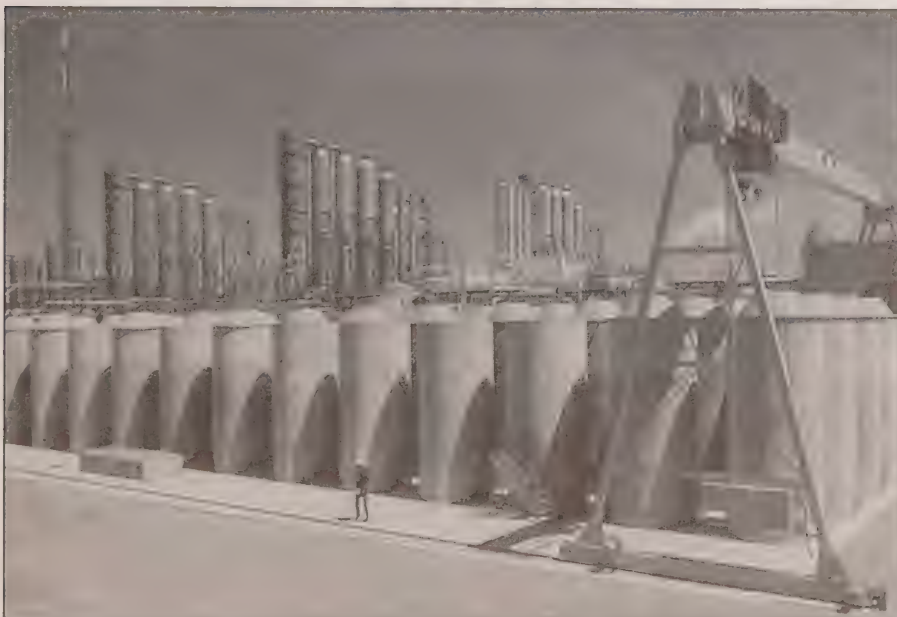
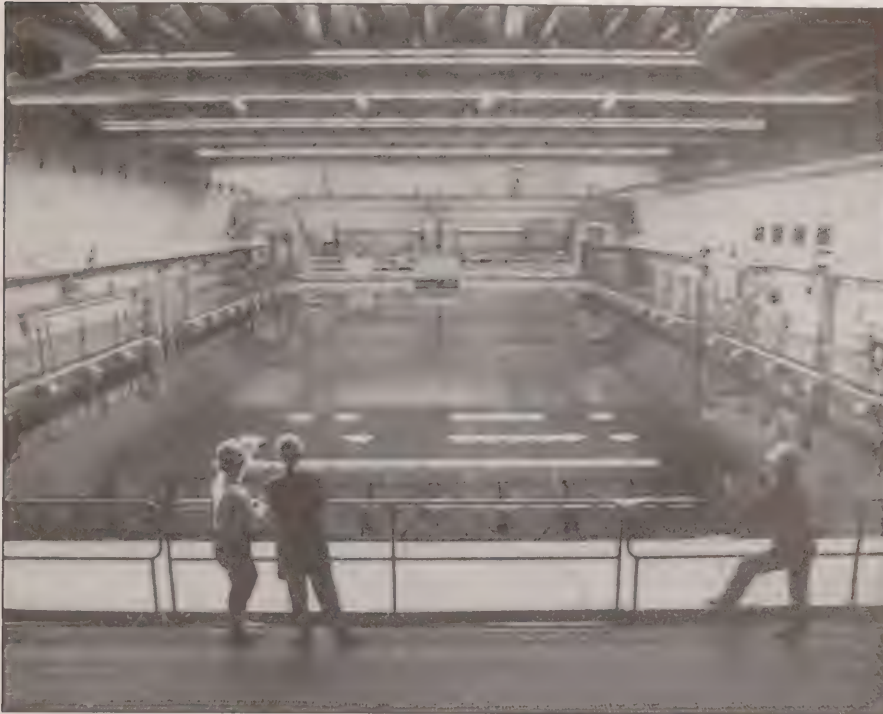
Canada's inventory of HLW continues to grow

3.43 AECL documentation indicates that, on 31 December 1992, the accumulated inventory of used fuel in Canada was about 900,000 bundles — each bundle being about the size of a fireplace log. The total volume would fill

approximately one and a half Olympic-size swimming pools. About 87 percent of this used fuel was produced by Ontario Hydro, 6 percent by New Brunswick Power, 4 percent by Hydro-Quebec and 3 percent by AECL.

3.44 Canada's 22 operating nuclear power reactors are generally expected to have a 40-year life. It is anticipated that these reactors will produce a total of over four million bundles of used fuel by the end of 2033. This volume would be

Used fuel, a form of high-level radioactive waste, can be safely stored, as an interim measure, in a water-filled pool or in a dry storage system using concrete canisters (see paragraph 3.42).



Source: AECL

A major research and development program to find a solution for disposing of HLW has gone on since 1978.

equivalent in size to about seven Olympic-size swimming pools.

Many research studies have been undertaken with the aim of developing a HLW disposal facility

3.45 Although both wet and dry storage are acceptable interim methods for storing HLW, it has been recognized by the Canadian government, operators, experts in the field and regulators in other countries that a long-term solution is necessary. Such a solution is required because some of the radioactive material in used fuel remains hazardous for tens of thousands of years.

3.46 Many studies have been undertaken in Canada and internationally to research the development of a disposal solution for HLW. In 1977, an independent expert group commissioned by the Department of Energy, Mines and Resources issued a report entitled *The Management of Canada's Nuclear Wastes*. The report concluded that Canada "needs a consolidated plan for the management of radioactive wastes now." It considered underground disposal in geological formations to be the most promising option within Canada. This report was studied by the Standing Committee on National Resources and Public Works. The Committee, after receiving presentations from many sources, recommended in 1978 that "an intensive research and development program into all facets of nuclear waste management be pursued on an urgent basis."

Since 1978, federal taxpayers have spent approximately \$370 million on developing a concept for HLW disposal

3.47 Since the late 1950s, AECL has been researching methods for storing and disposing of HLW. A major research and development program to find a solution

for disposing of HLW was initiated in 1978. This program, the Canadian Nuclear Fuel Waste Management Program, involves a partnership between AECL and Ontario Hydro. According to AECL, about \$538 million has been spent, from 1978 to March 1995, on researching and developing the concept of deep geological disposal in hard rock. Of this amount, about \$370 million was federal funding to AECL, about \$133 million was provided by Ontario Hydro, and the balance came from other sources, primarily foreign waste management research agencies. Until 1987, most of the research and development was funded by AECL. Since then, Ontario Hydro has been increasing its share of the funding for this program.

3.48 In October 1994, based on the research program, AECL submitted an Environmental Impact Statement for the HLW disposal concept to a federal environmental assessment and review panel.

Canada's schedule for disposing of its HLW has been extended by 25 years, to 2025

3.49 Many countries with nuclear power programs are searching for a disposal solution for their HLW. There has been an exchange of information and collaboration with respect to research and development among these countries.

3.50 We believe that it is important to have some form of benchmark to assess progress of the Canadian HLW program. At the recommendation of experts in the nuclear industry, we visited Sweden, Finland and France to discuss their radioactive waste management programs. The experts viewed these countries as having made progress in finding solutions for their high-level as well as their low-level radioactive waste. Our analysis compared the progress made in these

countries with the progress made in Canada. However, Natural Resources Canada believes that comparisons should be made with a broader range of countries, rather than just the three countries visited.

3.51 Features of the programs of the countries visited are described in Exhibits 3.3, 3.4 and 3.5. Like Canada, Sweden and Finland have conducted research and development on placing HLW in repositories in hard rock. Sweden's program, which is similar to Canada's, began about the same time.

3.52 Sweden started major work on the long-term management of HLW in 1977 as a result of a legal requirement to find a solution before fuelling any new reactors. A technical concept for deep disposal in hard rock was developed by the Swedish Nuclear Fuel and Waste Management Company in the late 1970s and was presented for approval in 1983. The Swedish nuclear regulatory agency accepted the concept in 1984. Since that time, the process of searching for potential

sites has continued, and further research and development on these sites is being carried out. In 2008, Sweden plans to have an operating repository that, in its initial stage, will receive 5 to 10 percent of the country's used fuel.

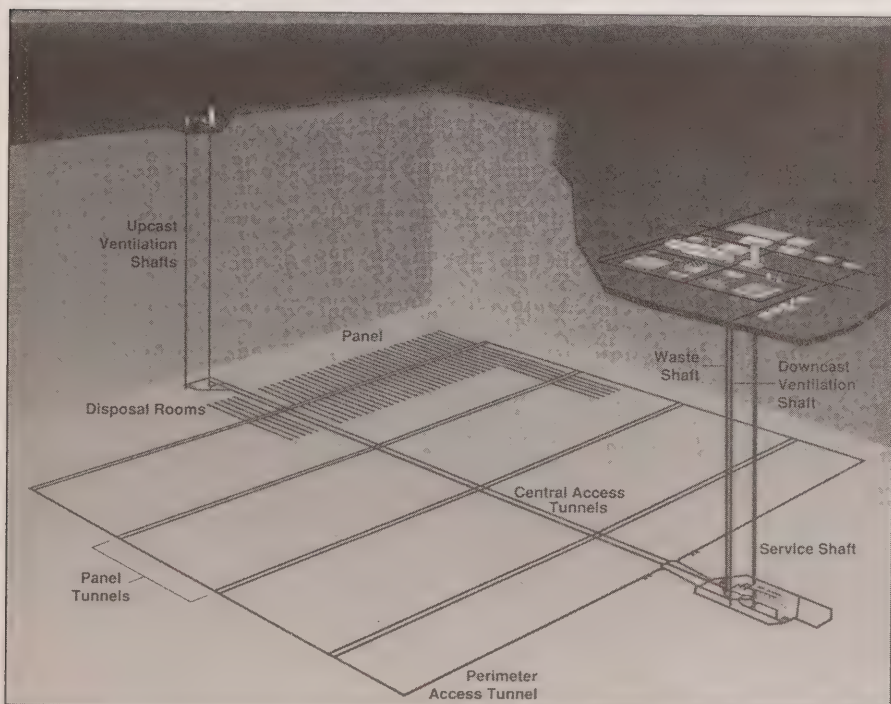
3.53 Canada's initial schedule, developed in 1978, anticipated that a disposal demonstration program would commence in 1985, with a full-scale facility being operational by 2000. However, there have been many delays in the Canadian program. A waste disposal concept has not yet been approved and siting has not started. The Environmental Impact Statement does not forecast a fully operational HLW disposal facility before 2025, which would mean an extension of 25 years beyond the date initially scheduled.

Social and environmental considerations have slowed the Canadian program

3.54 There are many reasons for the delay in finding a solution for HLW in

There have been many delays in the Canadian HLW program.

A conceptual picture of a deep geological underground disposal facility for high-level radioactive waste (see paragraph 3.47).



Source: AECL

Canada. After the launch of the Canadian Nuclear Fuel Waste Management Program in 1978, problems in finding a potential site for a HLW disposal facility became apparent. Many communities that were approached for permission to carry out local geological studies were opposed to such investigations. To address their concerns, the federal and Ontario governments announced in 1981 that a waste disposal concept would be developed and accepted before a site would be chosen. Public hearings were expected to be held as part of an environmental review, with acceptance or rejection of the concept targeted for 1990.

3.55 In September 1988, the Minister of Energy, Mines and Resources referred the disposal concept to the Minister of the Environment for a public review by an independent environmental assessment panel, in accordance with the Federal Environmental Assessment and Review Process Guidelines Order. In May 1989, AECL expected the review and approval of the concept by 1993.

3.56 The Minister of the Environment appointed a Federal Environmental Assessment and Review Panel in October 1989 to review the concept being developed by AECL. The terms of

Exhibit 3.3

The Radioactive Waste Management Program in Sweden

Sweden has four electrical utilities that own, in total, 12 nuclear power reactors.

Legislation

Swedish legislation of 1977 assigns to the nuclear power reactor owners the full technical and financial responsibility for the safe management and final disposal of all used fuel, as well as nuclear waste generated in their installations, including decommissioning wastes.

Reactor owners are required to pay a fee into interest-bearing accounts to cover present and future costs of final disposal of used fuel and decommissioning of the nuclear reactors. The funds are controlled by the Swedish Nuclear Power Inspectorate.

Waste Management Responsibility

The nuclear power companies have set up a jointly owned waste management company, the Swedish Nuclear Fuel and Waste Management Company (SKB), to meet their collective legal requirements for high-level and low-level radioactive waste.

Status of High-Level Radioactive Waste Management

SKB developed a technical concept for the disposal of high-level waste in the late 1970s. In 1983, this concept for the disposal of high-level waste in hard rock was presented for approval. In 1984, the concept was accepted, as the basis for further research, by both the Swedish Nuclear Power Inspectorate and the Swedish Government.

Geological investigations have been made on more than 10 sites from 1977. Apart from general studies of the whole country, SKB plans to conduct feasibility studies in five to ten municipalities. Site investigations will be conducted on 2 of the 5–10 sites, and a detailed characterization will be made on one site. SKB plans to have an operational facility by the year 2008.

Status of Low-Level Radioactive Waste Management

A low-level and intermediate-level radioactive waste repository owned by SKB was constructed more than 50 metres under the Baltic Sea. The repository, opened in 1988, was designed to isolate the radioactive wastes for 500 years. It was constructed for operational radioactive waste but can be expanded to take future decommissioning waste. The costs of the facility are paid by the producers, based on the quantity of waste sent to the facility.

reference for the review were made public. In March 1992, after consultation with various stakeholders, the Panel finalized guidelines for the preparation of the Environmental Impact Statement.

3.57 On the basis of the Panel guidelines, AECL prepared the Environmental Impact Statement on the concept for disposal of HLW and submitted it in October 1994. The Panel's review of the Environmental Impact Statement will include public input and technical reviews to ensure conformity with the guidelines. The Panel is expected to make its recommendations to the federal ministers of the Environment and of Natural Resources in late 1996. This is three years later than anticipated in

1989 and six years later than the target date set by the governments in 1981.

3.58 The Panel's recommendations are expected to address the safety and acceptability of AECL's HLW disposal concept and to provide some advice on the future steps to be taken in the management of nuclear fuel waste. The federal government, in co-operation with the Ontario government, would then make a final decision on whether and how to proceed with the implementation of the concept.

Action needs to be taken to ensure that Canada's HLW disposal program moves forward

3.59 Natural Resources Canada has not assessed alternative institutional

Natural Resources Canada has not assessed alternative institutional frameworks or funding arrangements that could be used to implement an approved HLW disposal concept.

Finland has two electrical utilities that each own two nuclear power reactors.

Legislation

In 1983, the Finnish government formally required the utilities to dispose of their used fuel and radioactive waste from operation and decommissioning of the nuclear power reactors. The government decision also contains the timeframe for achieving disposal of used fuel, 2020, and interim milestones. Progress beyond each of the milestones requires government approval.

Legislation requires each utility to pay into a state fund for the future costs of disposing of its used fuel and the decommissioning of its reactors, as well as for all the other future costs of nuclear waste management.

Waste Management Responsibility

Each utility is responsible for the management of its own high-level (used fuel) and low-level radioactive waste, as well as for the related research. They are also responsible for decommissioning their nuclear facilities. Discussions on co-operation for the disposal of used fuel are under way.

Status of High-Level Radioactive Waste Management

One utility has an agreement to export its used fuel until 1996. After this date it will have to begin developing its own repository for the balance of its used fuel. Since 1983, the other utility has been looking for a site to build its high-level radioactive waste repository. Currently, it is investigating three sites in Finland, while developing the technology to build the repository on any one of the sites.

Status of Low-Level Radioactive Waste Management

The 1983 Government Decision contained requirements for disposing of low-level radioactive waste. One utility has constructed a low-level waste repository designed to isolate the radioactive wastes for 500 years. This repository, which opened in 1992, receives operational radioactive waste. It will be enlarged to receive decommissioning waste. The other utility has a repository under construction.

Exhibit 3.4

The Radioactive Waste Management Program in Finland

frameworks (including roles and responsibilities) or funding arrangements that could be used to implement an approved HLW disposal concept. Some other countries have already adopted an approach for implementing their HLW disposal concept. As these countries have their own unique institutional structure, it is difficult to make direct comparisons to Canada. However, we believe that it is important to have information on the alternative approaches adopted by other countries.

3.60 Sweden, Finland and France each set out a clear national approach that established objectives for HLW management and assigned roles and responsibilities for all stakeholders. Each country took a different approach, but outlined what was to be achieved and how it was to be financed. In all three countries, the national approach was promulgated in legislation.

3.61 Sweden's four utilities established a single agency to dispose of

Exhibit 3.5

The Radioactive Waste Management Program in France

France's only electrical utility operates 54 nuclear power reactors. France reprocesses its used reactor fuel.

Legislation

The French government passed a law in 1991 that created the Agence nationale pour la gestion des déchets radioactifs (ANDRA), a public radioactive waste management company. The legislation outlines ANDRA's responsibilities.

This legislation also defines the research programs to be undertaken on high-level radioactive waste. The French Parliament must make an overall assessment of the research programs by 2006.

Waste Management Responsibility

ANDRA is responsible for designing, constructing and operating disposal facilities. In this capacity, it maintains an inventory of all waste in the country and provides producers with technical specifications for waste packaging and transport.

The Commissariat à l'Énergie Atomique (CEA) has the responsibility for researching the toxicity of radioactive waste and improving packaging for long-term storage. ANDRA is also participating in this research. In addition, ANDRA is responsible for researching the toxicity and volume reduction of radioactive waste.

Status of High-Level Radioactive Waste Management

The high-level radioactive waste, defined by France as wastes whose radioactivity takes longer than 300 years to reach non-hazardous levels, is currently stored on the producer's site. There is no state fund for future costs of these wastes or decommissioning wastes, as such provisions are made by the waste producers, which are state-owned companies. ANDRA's current research is paid for by the owners of HLW. The funding for the CEA's research is primarily from the government.

Status of Low-Level Radioactive Waste Management

ANDRA has two facilities for low-level radioactive wastes, defined as wastes whose radioactivity reaches non-hazardous levels in less than 300 years, Centre de la Manche and Centre de l'Aube. The La Manche site, which opened in 1969, reached its capacity in 1994 and is entering the closure and institutional control phase. The Aube site, which opened in 1992, is expected to operate until 2035. Both are near-surface facilities that isolate wastes from the environment for at least 300 years. The producers of the waste pay by the quantity of radioactive waste that they ship to ANDRA's facilities.

their HLW. In Finland, the two utilities are responsible for disposing of their own HLW and are currently developing their plans. Both countries are now conducting operationally related research and development for HLW disposal. France has assigned responsibility for waste management and final disposal to a national agency independent of producers. France has also set up a national research program to identify other technical solutions for the reduction of high-activity and long-lived waste.

3.62 Canada has experienced several delays in its HLW disposal program. It has also not kept pace with the Swedish and Finnish programs, which are developing similar HLW disposal concepts and have set out a national approach.

3.63 To assist the federal government in making its decision after it receives the Panel's recommendations, Natural Resources Canada must be in a position to provide advice on alternative approaches for moving the HLW program forward. In our opinion, Canada must take action to ensure that its HLW disposal program does not fall further behind its current schedule and that of some other countries.

3.64 **Natural Resources Canada should, as soon as possible, develop alternative approaches to move Canada's high-level waste program forward. These approaches should be developed in consultation with other federal and provincial departments and agencies, utilities with nuclear power reactors and other major stakeholders.**

Department's response: Agreed. The Canadian Environmental Assessment Agency (CEAA) Panel on the Nuclear Fuel Waste Management and Disposal Concept is expected to make its recommendations to the Minister of Natural Resources and the Minister of the

Environment in late 1996. The CEAA Panel recommendations will address the safety and acceptability of the disposal concept and the next steps regarding the safe, long-term management of nuclear fuel waste in Canada.

The federal government has directed Natural Resources Canada to develop, in consultation with major stakeholders, an overall strategy with options, which would address the implementation of disposal of all radioactive waste in Canada, namely, nuclear fuel waste, low-level radioactive waste and uranium mine tailings. The options developed in the strategy will assist the government in responding to the Panel's recommendations.

No funding arrangements are in place to implement a long-term solution for HLW

3.65 To date, the federal and Ontario governments have jointly funded the Canadian Nuclear Fuel Waste Management Program for the research and development of a concept for HLW disposal. The funding levels are determined by negotiation between the two levels of government. Funding for the Ontario portion is provided through Ontario Hydro and for the federal portion through AECL. The federal funding for AECL's research and development under this program expires on 31 March 1997.

3.66 AECL has estimated, based on the results of this program, that the cost of finding a site and constructing, operating and closing a HLW disposal facility for five million bundles of used fuel is about \$9 billion (in 1991 dollars). This estimate includes ongoing research and development on potential sites but excludes costs of monitoring the environment around the facility.

3.67 The three utilities with nuclear power reactors include a charge for radioactive waste disposal in their electrical rates. They also have made

provisions in their financial statements to recognize a liability associated with the cost of disposing of their used fuel. To date, these provisions total in excess of \$800 million.

3.68 Many assumptions are required to estimate the future cost of a long-term solution for HLW. These include such factors as the actual volume of used fuel, the type of long-term solution, the date the facility will be operational, the transportation distance to the facility, and the interest rates and inflation rates during the entire period. Since there has been no agreement on an approach, the assumptions underlying the current provisions may change and will need to be reviewed.

3.69 There are no arrangements in place to ensure that when the federal funding for the current research program ends, other funds will be available, when needed, to conduct further research and development and to implement the long-term solution.

Required knowledge and expertise must be maintained

3.70 Canada's significant investment in time, money and effort in researching and developing the deep geological disposal concept has resulted in specialized knowledge and technical expertise. Some of this knowledge and expertise is required to proceed with implementation of the disposal concept for HLW. However, the federal government's funding of AECL's research and development for HLW extends only to 31 March 1997. There is no agreement on the application and maintenance of this knowledge and expertise.

3.71 Once a decision has been made to proceed with implementation of a long-term solution for Canada's

high-level waste (HLW), Natural Resources Canada should reach an agreement with the major stakeholders on the best approach for implementation. The approach should include:

- a common vision and purpose, and a basic set of principles for HLW management in Canada;
- federal policy direction on all key aspects of the management of HLW;
- an appropriate institutional framework outlining the roles and responsibilities of all stakeholders and providing a basis for commitment and accountability;
- target dates for the transition to the long-term solution;
- arrangements to ensure that funding will be adequate and available, when needed, to conduct further research and development and to implement the solution; and
- maintenance of the core knowledge and expertise required for implementing the solution.

Department's response: Agreed. As stated in our response to the first recommendation, Natural Resources Canada is consulting with major stakeholders on a policy framework, including institutional and financial options, for a comprehensive approach to the disposal of radioactive waste in Canada, including nuclear fuel waste. The policy framework will address the issues of timing, progress, and responsible implementing organization. In consultation with the Atomic Energy Control Board, financial arrangements will be addressed to ensure that funds are in place for the disposal of the nuclear fuel waste.

The federal government has made a significant financial investment in developing the core knowledge and expertise related to the development of the

disposal concept for nuclear fuel waste in Canada. The federal government recognizes the importance of ensuring that the required knowledge and expertise be available to facilitate the timely implementation of the disposal concept. This issue will be addressed in the development of the federal policy framework.

Observations on Low-Level Radioactive Waste (LLW)

3.72 The audit findings on LLW are presented separately for wastes from current operations and for historic wastes. LLW from current operations and decommissioning is the responsibility of the producers or owners. In the case of historic wastes, the government has accepted residual responsibility. The different types of LLW also require different technological approaches to their long-term management.

3.73 The 1992 federal inventory of LLW indicates that Canada is currently storing small volumes of LLW from decommissioning activities. As future nuclear facilities are retired, the volume of LLW from decommissioning will increase. Appropriate long-term solutions for this LLW are expected to be similar to those for operational waste.

Operational Low-Level Radioactive Waste

3.74 Various radioactive elements can be found in operational LLW. Most operational LLW decays to non-hazardous levels in 500 years. Technology is being developed in Canada to find long-term solutions for this waste. However, some radioactive elements in LLW are long-lived and may have to be segregated and managed in a manner consistent with HLW. Therefore, a complete solution for

all operational LLW may depend on finding a solution for HLW.

Canada's inventory of operational LLW continues to grow

3.75 The 1992 federal inventory of LLW indicates that the total accumulation of operational LLW was about 150,000 cubic metres. Today, AECL is storing over 100,000 cubic metres, which is about two thirds of Canada's total operational LLW. This waste has been accumulating at an average annual rate of about 6,000 cubic metres. About 60 percent of this annual accumulation is owned by Ontario Hydro.

3.76 Operational LLW is currently stored at 18 AECB-licensed sites. Through its licensing and inspection activities, the AECB provides assurance that the waste at each of these sites is safely stored. One of these sites includes Canada's only commercial LLW storage facility, which is operated by AECL.

Owners are working toward solutions for their own waste

3.77 In Canada, Ontario Hydro, the Low-Level Radioactive Waste Management Office and AECL are working toward finding long-term solutions for operational LLW. The other two nuclear utilities have indicated that they are monitoring regulatory policy, the development of technology and the availability of disposal facilities before deciding on a strategy to dispose of their own LLW.

3.78 Ontario Hydro, a major producer of LLW, published a plan that outlines possible approaches for disposal of its own LLW. These approaches include developing an independent Ontario Hydro LLW disposal facility, or working with other waste producers to develop a joint multi-user disposal facility. Ontario

Hydro intends to have some form of LLW disposal facility in operation by 2015.

3.79 The federal government issued a policy in 1986 on the management of LLW. This policy defines the responsibilities of the federal government, including its residual responsibility to develop LLW disposal facilities for small producers, such as hospitals, which are not in a position to develop their own facility.

3.80 The Low-Level Radioactive Waste Management Office, currently funded by Natural Resources Canada and operated by AECL, was formed in 1982 with the mandate to establish, as required, a user-pay service for the disposal of LLW that is produced on an ongoing basis. The

Low-Level Radioactive Waste Management Office is also mandated to resolve historic waste problems that are a federal responsibility. Other than the preparation of an inventory of operational LLW in Canada and the completion of a number of studies on topical LLW management issues, the Low-Level Radioactive Waste Management Office has made little progress in establishing a user-pay service. Its priority has been on cleaning up historic wastes.

3.81 Studies completed under the direction of the Low-Level Radioactive Waste Management Office have indicated that the most cost-effective approach for developing a user-pay service would have to involve at least one of the major

Operational low-level radioactive waste is stored in AECB-licensed waste management storage sites such as these at AECL's Chalk River site (bottom) and Ontario Hydro's waste management facility (right) (see paragraph 3.76).



Source: AECL and Ontario Hydro



producers. The Low-Level Radioactive Waste Management Office wishes to avoid establishing a facility dedicated solely to the needs of the small producers. Thus, collaboration with major producers will be required to develop such a facility.

3.82 A commercial LLW storage facility is currently available for small producers to transfer their radioactive waste to AECL. However, AECL will eventually have to dispose of this waste. For all operational LLW that it possesses, AECL has developed a draft strategic plan to make the transition from interim storage to long-term solutions.

AECL is researching technologies for disposing of LLW

3.83 AECL has spent more than 15 years and \$53 million researching and developing technologies for disposing of LLW. For example, it has carried out research on waste characterization and migration of different types of LLW.

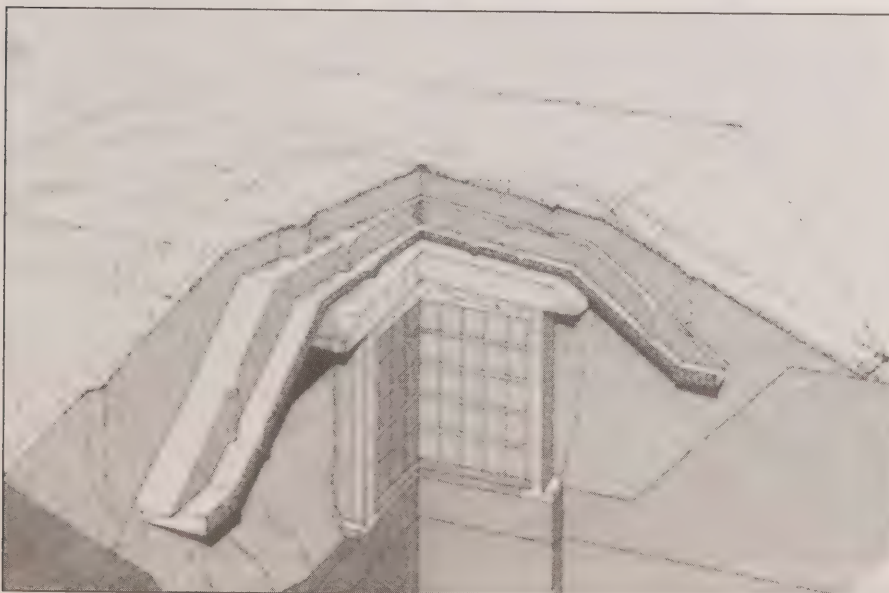
3.84 One of the technologies being developed is a concept known as IRUS (Intrusion Resistant Underground

Structure). The IRUS concept is a series of underground concrete vaults designed to contain LLW for 500 years. After that time, the waste will no longer be hazardous. An IRUS prototype, which will contain LLW from AECL's own operations as well as waste from its commercial storage facility, is scheduled for operation by 1998–99. AECL has submitted its technical studies on the prototype to the AECB for review. The AECB has raised technical issues to be addressed before approval of the IRUS concept.

Canada does not have an approved disposal technology or any disposal facilities for its LLW

3.85 Today, all operational LLW in Canada is being placed in interim storage facilities. Interim storage adds to the ultimate cost of disposing of this waste. Until a disposal facility is available, expenditures will be incurred to manage the stored material and to build additional storage facilities as needed. Once a disposal facility is available, additional expenditures will be incurred to recover the waste and transfer it to the disposal

Long-term solutions for Canada's operational LLW need to be implemented to reduce the lifetime costs and radiation hazards.



Conceptual drawing of the IRUS (Intrusion Resistant Underground Structure) disposal facility, which is to contain low-level radioactive waste that will no longer be hazardous after 500 years (see paragraph 3.84).

Source: AECL

facility, and to decommission the old storage facilities. Moreover, handling of the waste during retrieval and transfer to the disposal facility can result in additional exposure of workers to radiation.

3.86 The expense of storage and the unnecessary exposure to radiation could be avoided or reduced if disposal facilities for LLW were available. Long-term solutions for Canada's operational LLW need to be implemented to reduce the lifetime costs and radiation hazards, to ensure that the producer pays and to minimize the burden on future generations.

3.87 Sweden, Finland and France have characterized their LLW in terms of life span and level of radioactivity and have moved from storage to disposal for shorter-lived (up to 500 years) waste. Permanent LLW disposal facilities are in operation in Sweden (1988), Finland (1992) and France (1992). A French facility that opened in 1969 reached its capacity in 1994 and is entering the closure and institutional control phase. More information on these countries is provided in Exhibits 3.3, 3.4 and 3.5.

3.88 Canada does not have an approved disposal technology or any disposal sites for its LLW. It has not yet determined what will be needed in the way of disposal services and facilities. In addition, there is no co-ordinated plan or timetable for disposing of Canada's operational LLW.

3.89 Natural Resources Canada should obtain agreement with the major stakeholders on roles and responsibilities, a plan, a timetable and funding arrangements for disposing of Canada's operational low-level waste. This plan should be co-ordinated with the approach for high-level waste.

Department's response: Agreed. As highlighted in our response to the first recommendation, Natural Resources Canada is proceeding to develop a policy framework, including institutional and financial options, for a comprehensive approach to the disposal of radioactive waste in Canada, including operational low-level waste. Consultation with the major stakeholders is an important step in the development of an agreed-upon strategy and timetable for the disposal of all low-level radioactive waste.

Historic Low-Level Radioactive Waste

Background

3.90 Historic wastes are low-level radioactive wastes for which the original producer or owner can no longer reasonably be held responsible. These wastes were managed in a manner no longer considered acceptable. The federal government has accepted residual responsibility for these wastes. The Low-Level Radioactive Waste Management Office was established by the federal government to carry out its responsibilities for LLW management in Canada. Under the Low-Level Radioactive Waste Management Office's historic wastes program, clean-up and interim remedial work is performed at historic waste sites.

3.91 Historic wastes differ from most operational LLW in that they contain long-lived radioactive elements as well as hazardous chemicals similar to uranium tailings. This waste generally remains hazardous for over 500 years, since much of it contains radium and uranium refinery waste. In addition, some of the hazardous chemicals last indefinitely.

3.92 Today, historic wastes constitute the largest volume of Canada's low-level radioactive waste inventory. The

inventory of historic wastes was estimated by the Low-Level Radioactive Waste Management Office in 1992 to be about 1.2 million cubic metres. This waste is largely the result of the radium industry and the early years of uranium production.

3.93 The majority of the historic wastes was produced at the refinery owned by Eldorado Nuclear Limited, in Port Hope, Ontario. The refinery waste was initially deposited at several sites in Port Hope; over time, contamination spread to other locations. Later, Eldorado Nuclear established the Welcome and Port Granby waste management storage sites at nearby communities. The federal government has accepted residual responsibility for locating a permanent site and finding a long-term solution for all of the historic wastes found in the Port Hope area.

3.94 Other historic wastes are located in Scarborough, Ontario, in Surrey, British Columbia, and in various areas in Alberta and the Northwest Territories. The Low-Level Radioactive Waste

Management Office has separate projects to clean up these sites and manage the radioactive wastes.

The federal government monitors historic waste to ensure that there is no immediate risk to public health

3.95 The AECB licenses seven waste management storage sites containing historic wastes. Four of these sites are located in Port Hope and one is located in Scarborough. These five sites are managed by the Low-Level Radioactive Waste Management Office, under licences held by AECL. The other two licences are held by the current owner of the Port Hope refinery, Cameco Corporation, for its Welcome and Port Granby sites. In addition, both AECL and the Low-Level Radioactive Waste Management Office store some historic wastes at AECL's Chalk River site, which is licensed by the AECB. Through its licensing and inspection activities, the AECB provides assurance that the waste at each of these sites is safely stored.



One of the AECB-licensed sites in the Town of Port Hope, where historic low-level radioactive waste is being stored (see paragraph 3.95).

Source: Siting Task Force (Ontario)

3.96 There are also nine major unlicensed and unremediated sites containing historic wastes in Port Hope. The management and monitoring of these sites are the responsibility of the Low-Level Radioactive Waste Management Office. In April 1994, a report was prepared by Natural Resources Canada in co-operation with the Low-Level Radioactive Waste Management Office and the Secretariat to the Siting Task Force on Low-Level Radioactive Waste Management and corroborated by officials from both Health Canada and the AECB. The report concluded that the current situation at these sites does not pose an immediate risk to public health.

3.97 However, the federal government is still concerned that wastes that do not pose a risk to public health or the environment at the present time might pose a risk in the future. This could occur, for example, through a breakdown in physical containment or a lapse in management of the wastes.

After \$21 million and eight years, no disposal site has been found for Port Hope area historic wastes

3.98 Since the early 1980s, unsuccessful attempts have been made to find a disposal site for Port Hope area waste. Following requests from the AECB in 1980, Eldorado Nuclear Limited attempted to establish a disposal site for its LLW in the Port Hope area. These attempts failed, in part because of public opposition to the proposed locations and the methods being used to select the sites.

3.99 In December 1986, the federal government set up a siting process to find a permanent solution for the Port Hope area waste. To date, this process has involved three consecutive task forces. The first task force recommended a siting

approach requiring community agreement on a potential site. This recommendation was accepted by the federal government in 1987 on the basis that it was more co-operative and less confrontational than previous approaches. Based on this approach, subsequent task forces were set up to identify possible communities and sites.

3.100 The current task force is to make recommendations on the long-term management options and to identify possible sites for a disposal facility for this historic waste. The report of the task force was originally expected by 31 March 1995, but has been delayed until 30 September 1995.

3.101 In our view, at the outset of this siting process, we would have expected to find a plan that could be implemented in the event that no sites were found. We did not find such a plan. In the last eight years, Natural Resources Canada has spent approximately \$21 million on the siting process. At this time, no agreement has yet been reached with a community on a disposal site.

3.102 The federal government is also incurring costs for the management of historic wastes at the Welcome and Port Granby sites. These wastes were produced by Eldorado Nuclear Limited, a federal Crown corporation. The total amount of the expenditure will depend on how long it takes to find a long-term solution and on the need for remediation work in the interim. Cameco Corporation assumed ownership of these historic wastes for management purposes under the terms of the 1988 purchase agreement that transferred assets from Eldorado Nuclear to Cameco. Under that agreement, Cameco agreed to keep these historic wastes segregated. Under the agreement's joint cost-sharing formula, the federal government retains primary

financial liability for the ultimate cost of storage and disposal of these historic wastes. Cameco assumed some financial responsibility under the formula, with its liability limited to \$25 million.

3.103 Once a site has been found for the Port Hope area waste, the federal government will incur significant costs, estimated by the current task force to be between \$185 million and \$309 million. These estimates include the design and construction of a disposal facility, as well as transportation of waste to the facility. The estimates do not include any potential benefit compensation package for the community accepting the facility. The facility is expected to contain the Port Hope area and Scarborough historic wastes.

3.104 For the Port Hope area historic wastes, we expected to find a federal strategy for the identification of suitable sites and preferred technologies. We also expected to find a plan for the implementation of a long-term solution, including target dates and estimates of costs. Such a plan would provide a basis for commitment and accountability. The siting process addresses the identification of suitable sites and preferred technologies, estimates costs and proposes a management mechanism to oversee the final design, construction and operation of the facility. It does not address the target dates for making critical decisions leading to a solution.

3.105 Once the current Siting Task Force makes its recommendations, Natural Resources Canada should establish a plan, with target dates, for implementing a long-term solution for the Port Hope area historic wastes.

Department's response: The federal government will respond, as appropriate, to the recommendations of the

independent Siting Task Force on Low-Level Radioactive Waste Management in Ontario. This may involve establishing a plan, with target dates, for implementing a solution to the long-term management of the historic low-level radioactive waste, taking into consideration the recommendations of the Siting Task Force, which are expected on 1 October 1995. The Siting Task Force has a mandate to find a site for the Port Hope area wastes, using a co-operative, consultative and community-based process. It is presently in the final phases of the siting process.

Canada's historic wastes require further clean-up

3.106 For over a decade, the Low-Level Radioactive Waste Management Office has carried out projects to clean up radioactive contamination from historic waste sites across Canada, including the Port Hope area, at a total cost to date of about \$9 million.

3.107 Historic wastes from the Low-Level Radioactive Waste Management Office's clean-up projects have been segregated on the basis of their radiological hazard. Material that is more highly contaminated is now stored at AECB-licensed sites, pending its removal to a permanent disposal site. In some cases, the remaining mildly contaminated soil has been consolidated and stored near the source until it too can be moved to a permanent disposal site. Other mildly contaminated soil, classified as industrial waste, has been disposed of at a local landfill site. The Low-Level Radioactive Waste Management Office believes that new findings of historic wastes in Canada will likely continue, but no large sites are expected to be found.

3.108 The Low-Level Radioactive Waste Management Office estimates that, over the next five years, approximately \$25 million in additional federal funding

The siting process for the Port Hope area waste does not address the target dates for making critical decisions leading to a solution.

will be required to complete the clean-up and to find long-term solutions for identified historic waste sites, excluding major sites in Port Hope. The current funding of the Low-Level Radioactive Waste Management Office expired on 31 March 1995. Lack of continued effort to clean up historic wastes will create a gap in federal management of these wastes.

3.109 Natural Resources Canada should seek continuity in federal responsibilities for the management of Canada's historic low-level radioactive wastes.

Department's response: Agreed. The federal government has extended the mandate of the Low-Level Radioactive Waste Management Office, the federal agent designated for cleaning up historic low-level radioactive waste.

Observations on Uranium Tailings

Background

3.110 The creation of uranium tailings through mining and milling of uranium ore began with the removal of radium for medical purposes in the early 1930s, prior to the establishment of the AECB. Over the years, this activity has taken place in the Northwest Territories, Ontario and Saskatchewan. In the early 1950s, the demand for uranium increased dramatically to supply foreign nuclear weapons programs. Between 1955 and 1958, 16 new mines were opened in the Elliot Lake and Bancroft areas in Ontario to meet the requirements of foreign defence contracts. By the end of 1964, with the winding down of these contracts, all but three mines in Canada had closed.

3.111 With the introduction of the first Canadian nuclear power reactors later in

the 1960s, uranium production in Canada became almost exclusively devoted to peaceful uses of nuclear power. In the late 1970s and the early 1980s, uranium mining activity of low-grade ore resumed in the Elliot Lake area when additional nuclear power reactors came on-stream globally and when uranium prices increased. During the 1980s, the substantial decline in uranium prices, coupled with the development of high-grade uranium mines in northern Saskatchewan, led to the closure of most uranium mines in the Elliot Lake area.

3.112 The one remaining mine in the Elliot Lake area, under contract to Ontario Hydro, is expected to cease operation in 1996. Today, no uranium mine is in production in the Northwest Territories. Three mines are operating in northern Saskatchewan. Six new or expanded mining facilities have also been proposed for Saskatchewan.

3.113 Uranium tailings, much like tailings from other mines, are typically concentrated in surface containment areas near the mine-mill complex. About 200 million tonnes of uranium tailings have accumulated to date, representing approximately three percent of all mine tailings in Canada.

3.114 In 1982, the Department of Energy, Mines and Resources (EMR) initiated a five-year National Uranium Tailings Program to research long-term management strategies for the protection of the public and the environment. In 1988, the Mine Environmental Neutral Drainage Program was initiated by the Department to analyze site-specific information on acid drainage and tailings management scenarios for all types of mine tailings. To date, Natural Resources Canada reports that approximately \$10 million has been spent under these two

programs on researching long-term solutions for uranium tailings.

Uranium tailings need to be properly contained and controlled

3.115 In addition to containing radioactive substances, hazardous chemicals are often found in uranium tailings. These tailings pose a potential hazard to the public and the environment if improperly contained. Also, uncontrolled access to mines and tailings sites could result in intrusion and, over time, habitation of the sites or misuse of the tailings as construction material.

3.116 The provinces have constitutional jurisdiction over mining. However, the *Atomic Energy Control Act* gave the AECB the responsibility, in 1946, for regulating the Canadian nuclear industry, including uranium mining.

3.117 For security purposes, the AECB initially issued permits to uranium mining companies to control the extraction of material. The single AECB requirement for health and safety in uranium mines was that permit holders comply with

applicable provincial regulations. In 1976, the AECB decided to explore measures to expand its regulatory control over uranium mining. A decision was made to introduce a licensing system.

3.118 From 1978, the AECB licences subjected the mining companies to additional federal regulatory control in the area of radiation protection for the mine workers, public health and environmental protection. Compliance with all relevant provincial regulations remained a condition of the licence. The AECB decided to issue licences only for those mines still in operation and for new uranium mines.

3.119 In 1988, the AECB's *Uranium and Thorium Mining Regulations* were enacted to require uranium producers to develop decommissioning plans for their mines and tailings management areas and to submit them to the AECB for approval. In 1994, the AECB amended these regulations to introduce the requirement for financial assurances for current and future AECB-licensed uranium mine sites. However, as the AECB guidelines for the implementation of these amendments have



Uranium tailings, which contain both radioactive substances and hazardous chemicals, are often concentrated in surface containment areas. These tailings need to be properly contained and controlled for tens of thousands of years (see paragraphs 3.14 and 3.110 to 3.115).

Source: Denison Mines Limited

The AECB cannot assure the public that the pre-1976 uranium tailings sites are being safely maintained.

Federal and Ontario officials have spent over a decade attempting to determine their roles and to assign residual responsibilities for uranium tailings sites.

not yet been completed, no financial assurances have been provided to the AECB for any licensed sites.

Pre-1976 uranium mines and tailings sites have not been subjected to the AECB's current regulatory regime

3.120 Ten uranium mines with tailings sites ceased operations prior to 1976 and were never subject to AECB's current regulatory regime. Consequently, the AECB does not formally inspect or otherwise monitor these sites to assess their impact on the environment or to ensure that there are no undue risks to health and safety.

3.121 Most of these unlicensed sites are in the Elliot Lake and Bancroft areas of Ontario, but there are other more remote sites in Saskatchewan and the Northwest Territories. The federal and provincial governments recognize that these pre-1976 sites have to be rehabilitated and decommissioned to current standards.

3.122 Until these unlicensed sites are brought under its regulatory control, the AECB cannot assure the public that the pre-1976 sites are being safely maintained.

3.123 The Atomic Energy Control Board should ensure that the pre-1976 tailings sites of unlicensed uranium mines are brought under its regulatory control.

AECB's response: Agreed. The AECB has committed to bring these tailings under AECB regulatory control. In December 1994, the AECB initiated discussions with known owners of the sites.

The federal and provincial governments have not assigned residual responsibilities

3.124 In accordance with the "producer pays" concept, the federal government's

position is that the primary responsibility for the management and long-term institutional care of uranium tailings rests with the producer or owner. However, where a producer does not exist, or the owner is unable or unwilling to pay, the federal and/or provincial governments, as the managers of last resort, will have to assume residual responsibility. Negotiated agreements between the federal and provincial governments are a prerequisite to the orderly assignment of these residual responsibilities.

3.125 The closure of several uranium mines and the existence of unregulated uranium tailings sites raised concerns at the federal level about the need to ensure that funds would be available to decommission these sites adequately. This situation prompted the Department of Energy, Mines and Resources to begin negotiations with the Ontario government on these and other concerns related to uranium tailings.

3.126 Federal and Ontario officials have spent over a decade attempting to determine their respective roles and to assign residual responsibilities for rehabilitating and decommissioning uranium tailings sites. Although some agreement has been reached by the officials as to how roles and responsibilities are to be assigned, the federal government has not yet formally approved this agreement. Similar discussions with the Saskatchewan government have yet to begin.

Different assumptions are being used by Natural Resources Canada and the AECB for decommissioning costs of uranium tailings

3.127 Natural Resources Canada has compiled details on volumes of uranium tailings and cost estimates for decommissioning tailings sites. This information is required to develop federal

policy and to support negotiations with the provinces on roles and responsibilities for tailings management. The AECEB maintains similar information for regulatory purposes.

3.128 The estimates for decommissioning costs for individual sites, and in some cases volume estimates, vary significantly between these two federal organizations. These variances are due, in part, to differences in the assumptions used in the calculations, as well as to the difficulty in estimating decommissioning costs without approved clean-up strategies in place. Nonetheless, Natural Resources Canada and the AECEB have not attempted to reconcile such differences.

3.129 Natural Resources Canada estimates that the total cost for decommissioning uranium tailings sites in Canada may exceed \$400 million (in 1994 dollars). In comparison, the AECEB's total estimate for the same sites, based on different assumptions, is less than half of this amount. Although these costs are generally expected to be paid by the producers or owners of the waste, Natural Resources Canada also estimates that the federal government's potential liabilities to meet its residual responsibilities could be in the tens of millions of dollars.

3.130 Natural Resources Canada and the Atomic Energy Control Board should reconcile their current information on volumes and costs for decommissioning uranium tailings sites.

Natural Resources Canada and the Atomic Energy Control Board's response: Agreed. Natural Resources Canada and the Atomic Energy Control Board will work together to ensure that there is a common understanding about the underlying assumptions that resulted in differences in estimates of the volumes and costs. These differences do not have any

operational impact on plans for the decommissioning of the uranium tailings sites.

Long-term storage for uranium tailings requires institutional care

3.131 In Canada, a "walk-away" solution is not realistic for decommissioning most uranium tailings sites. Long-term storage requires long-term institutional care to monitor and maintain the containment structures and to control access to, and use of, the land. It is expected that the owners will eventually seek permission from the AECEB to abandon their uranium tailings sites. Presently, there are no financial assurances that the funds required for long-term care will be available as needed.

3.132 No decision has been reached by the federal and provincial governments to assign residual responsibility for providing institutional care. Federal and Ontario officials have spent over a decade attempting to assign such roles and responsibilities.

3.133 In the case of the decommissioned site at Agnew Lake, Ontario, remedial work was carried out by the owner in the late 1980s. Following a request in 1990, the AECEB granted the owner permission to abandon this site. No financial assurances were sought from the owner for long-term institutional care of the site. Ownership of this site has reverted to the Province of Ontario. According to Natural Resources Canada officials, the long-term institutional care of this site has been a matter of discussion with Ontario officials as part of the negotiations on the assignment of residual roles and responsibilities.

3.134 Natural Resources Canada should move toward finalizing an agreement with the Ontario government

to assign residual roles and responsibilities for rehabilitation and decommissioning of uranium tailings sites and for the provision of long-term institutional care of all sites in the province. Natural Resources Canada should pursue similar discussions with the Saskatchewan government.

Department's response: Agreed. In fact, the governments of both Canada and Ontario have already supported the development of a Memorandum of Agreement based on an agreed-upon framework.

Natural Resources Canada will continue to be the federal lead for developing an agreement with Ontario on shared responsibility for the decommissioning and perpetual care of abandoned uranium mine sites. In addition, Natural Resources Canada has held preliminary discussions with Saskatchewan with a view to clarifying similar responsibilities.

Financial Implications of the Search for Long-Term Solutions

3.135 Since the 1970s, the federal government, including AECL, has spent approximately \$450 million on the search for long-term solutions for radioactive waste. This figure includes the following expenditures:

- approximately \$370 million, reported by AECL, on researching and developing a concept for disposal of high-level waste (HLW);
- approximately \$53 million, reported by AECL, on research and development for disposal of low-level waste (LLW);
- approximately \$21 million, reported by Natural Resources Canada, in trying to find a disposal site for the Port Hope area historic waste; and
- approximately \$10 million, estimated by Natural Resources Canada, on researching long-term solutions for uranium tailings.

3.136 Federal documentation indicates that over the next 70 years, at least \$10 billion will be needed to find and implement disposal solutions for Canada's radioactive waste. Almost all of the money is expected to come from the waste producers. Using various federal documents, we estimate the federal share, including AECL's portion, to be approximately \$850 million. It will be more if the federal government has to assume residual responsibility for other waste producers.

3.137 To date, none of the potential federal liabilities of approximately \$850 million have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada. Given the fact that these potential liabilities could affect the deficit, we believe that they should be disclosed.

3.138 The government should disclose, in the Notes to the Financial Statements and in the Notes to the Annual Financial Report, those potential federal liabilities related to radioactive waste that it can determine and reasonably estimate.

Treasury Board Secretariat's response: The government is aware that generally accepted accounting principles, as issued by the Canadian Institute of Chartered Accountants, call for recognizing environmental and site restoration costs and liabilities in financial statements. While some forecasts of costs may be available within the Government of Canada for the clean-up of specific items such as radioactive waste and site contamination, this is not the case for other environmental liabilities that the government is committed to address. The

cost to the government of all these commitments is not determinable at this time, and until reasonable estimates of these costs can be made, the government should not change its accounting policies to record partial costs. The determination of these costs, which are subject to and dependent upon evolving public policy, legislation and regulation, is currently under study. Where feasible, the note disclosure in the government's summary financial statements for fiscal year 1994–1995 will be enhanced to include those potential liabilities that can be determined and reasonably estimated.

Conclusions

3.139 Federal responsibility for managing Canada's radioactive waste, including the search for long-term solutions, is divided among many players. With the exception of the assignment of residual responsibilities for uranium tailings, current federal responsibilities for radioactive waste regulation, storage and research are clearly defined and assigned. However, roles and responsibilities for implementing long-term solutions for high-level and low-level wastes are not clearly defined and assigned.

3.140 While the various federal players understand their responsibilities, they are not always working together with other non-federal players on a common vision and agenda for disposing of Canada's radioactive wastes. The federal government, in consultation with major stakeholders, needs to develop this common vision and agenda.

3.141 We also identified the following areas requiring improvement in the discharge of federal responsibilities for radioactive waste management:

- Natural Resources Canada needs to develop federal policies to cover all classes of radioactive waste. Only one

formal federal policy has been documented, the 1986 policy on low-level waste (LLW) management.

- The Low-Level Radioactive Waste Management Office needs to pursue its mandate of establishing a user-pay service for disposing of LLW.

- The AECB needs to bring the pre-1976 uranium tailings sites under its current regulatory regime.

3.142 Canada has made progress in studying ways to resolve the problems associated with radioactive waste from a scientific and technological perspective. It has also made progress in cleaning up historic wastes. These efforts have been supported by significant taxpayer dollars. The federal government has spent approximately \$370 million to research and develop a disposal concept for high-level waste (HLW). Over \$80 million has been spent by the federal government on LLW research and development, clean-up of historic wastes and the search for a disposal site for the Port Hope area waste. The federal government has also spent approximately \$10 million on uranium tailings research.

3.143 The various efforts of the many federal players involved have not yet resulted in a timely resolution of the difficult national problem of disposing of our HLW and LLW. Today, Canada has no disposal facilities for any of its high-level or low-level radioactive waste. Canada has not kept pace with some other countries in moving toward the implementation of a long-term solution for HLW or in developing operational LLW disposal facilities.

3.144 The potential future costs of finding and implementing disposal solutions for Canada's radioactive waste are large — at least \$10 billion over the next 70 years. Almost all the money is expected to come from the waste

The various efforts of the many federal players involved have not yet resulted in a timely resolution to the difficult national problem of disposing of our HLW and LLW.

producers, with the federal government incurring only a small portion of these expenditures. We estimated this portion to be approximately \$850 million. However, the government has not disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada those potential federal liabilities related to radioactive waste that it can determine and reasonably estimate.

3.145 To ensure that the producer pays and to minimize the burden on future generations, the transition from interim storage to long-term solutions for

high-level and low-level radioactive waste requires the following:

- agreement among the stakeholders on an approach for implementing a long-term solution for Canada's HLW;
- agreement among the stakeholders on roles and responsibilities, a plan, a timetable and funding arrangements for disposing of Canada's operational LLW;
- a federal plan, with target dates, for implementing a long-term solution for the Port Hope area historic wastes; and
- continuity in federal responsibilities for the management of all of Canada's historic low-level radioactive waste.

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Report of the Auditor General of Canada to the House of Commons

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 4
Health Canada: Management of the
Change Initiative at Health Protection Branch

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 4
**Health Canada: Management of the
Change Initiative at Health Protection Branch**



May 1995

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Chapter 4

**Health Canada: Management of
the Change Initiative at Health
Protection Branch**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Health Canada: Management of the Change Initiative at Health Protection Branch

Assistant Auditor General: Maria Barrados

Responsible Auditor: Dan Rubenstein

Main Points

4.1 The Health Protection Branch (HPB) of Health Canada is mandated to carry out programs to assess and manage the public health risks faced by Canadians. It plays a unique national role in protecting Canadians against current and emerging public health risks.

4.2 Managers of the Branch were concerned that they could not continue to cut their budgets and, at the same time, meet their obligations to Canadians to manage current and new public health risks. In 1993, the Branch turned to a program of change management to help resolve this dilemma.

4.3 This chapter examines the early progress made by the Branch in bringing about change to deal with the dilemma facing it, as well as to fix some known program problems. We examined the initiative early in the change process to determine whether the Branch's experience could be of help to others facing the same pressures.

4.4 The Branch successfully marshalled the necessary resources to get the process under way. A reasonable initial process was developed and a vision of what was to be achieved was set out. A plan of action called the New Enterprise began implementation in April 1994.

4.5 The process resulted in a number of early achievements such as organizational changes, development of Branch policy and improvement to internal systems.

4.6 Some compromises were made early in the process. Necessary data on the effectiveness and related costs of programs and activities were not always available. Early attempts at developing an approach to the management of public health risks did not produce a useful result that clearly distinguished various public health risks. These areas need attention for the New Enterprise to move forward.

4.7 In areas of continued focus and attention, such as cost recovery, progress continues to be made. Targets have been set and increased revenue is being generated. The speed with which the Branch can reach its targets is strongly influenced by approval processes outside the Branch's control.

4.8 After the first early achievements, the momentum for change throughout the Branch slowed. Pressure had been kept on managers to change through regular review and scrutiny by an oversight committee. The Branch needs to explore ways of rekindling some of this early pressure and enthusiasm.

4.9 At this early phase of the change process, we found slow progress in fixing a number of known program problems. For example, while some action has occurred in the Drugs Directorate, key issues identified in past studies still remain outstanding. Similarly, for the Medical Devices Bureau, many of the changes recommended in 1992 are still not fully implemented. Success in making changes in programming will require sustained effort to solve these problems.

4.10 The experience of HPB points to the importance of managers being proactive. Government managers face many demands from inside and outside their organization for change in programming and budget requirements. By having initiated their own review process, managers in HPB were better positioned to meet the requirements of the government-wide program review and still be in a position to deal with Branch priorities. This ability to respond became even more important with the demands for continuous change and adjustment.

Main Points (cont'd)

4.11 The speed with which managers at the Branch can change their programs and activities is tied to the demands of approval processes outside the Branch, such as regulatory approval and authority for cost recovery. The challenge for government will be to find ways to accommodate government-wide requirements, while supporting initiatives in smaller units of government such as the Health Protection Branch.

Background

4.12 This chapter examines the initial progress of the Health Protection Branch (HPB) at Health Canada in changing its operations to meet public expectations for health protection, and fiscal requirements to reduce budget requests.

The Important Role of the Health Protection Branch

4.13 Canadians face risks to their health and safety every day. Threats to health come from environmental or industrial hazards, communicable disease, unsafe food, drugs, medical devices and other consumer products. The fundamental purpose of the Branch is to protect Canadians against current and emerging health risks. The broad public health activities of the Branch are mandated by federal legislation, as well as international agreements to which Canada is a signatory. The Branch plays a unique national role in ensuring the safety of the food supply, drugs, cosmetics and medical or radiation-emitting devices, as well as environmental health and disease surveillance. In assessing and managing these public health risks, the Branch conducts regulatory field visits to food and drug manufacturing plants, conducts premarket and postmarket evaluations of products, and provides national reference and diagnostic laboratory services, as well as surveillance and investigation of disease outbreaks.

4.14 The Branch employs approximately 2,360 people and had a budget of \$ 259 million in 1994–95. As illustrated in Exhibit 4.1, there are four core directorates. The work carried out in these directorates requires a wide range of scientific and regulatory skills supported by laboratories and technical equipment.

The investment in scientific work involves a longer-term commitment in facilities and people, requiring some degree of predictability in resources.

Dilemma for Branch Management

4.15 By early 1993, the Branch was experiencing increased budgetary pressures, as were other parts of government and other parts of Health Canada. The Branch anticipated being asked by Treasury Board and other parts of Health Canada to continually cut base budgets, which were \$180 million in 1993–94. HPB had also become increasingly reliant on time-limited or “sunsetted” funding (approximately \$50 million) that targeted specific health issues. In 1993–94, the Branch faced a base-budget reduction target of \$6.1 million. Fiscal restraint targets for 1994–95 were anticipated to cut another \$2.4 million from the Branch’s base budget, and further reductions were anticipated for 1995–96 and future years. At the same time, the Branch estimated that it required an additional \$4.9 million

The Branch plays a unique national role in public health.



Good science remains the core for Health Protection Branch Programs (see paragraph 4.14).

In response to the continual requests to cut budgets, managers of the Branch became concerned that they would not be able to meet their obligations to Canadians to protect public health.

for unanticipated and unfunded program priorities.

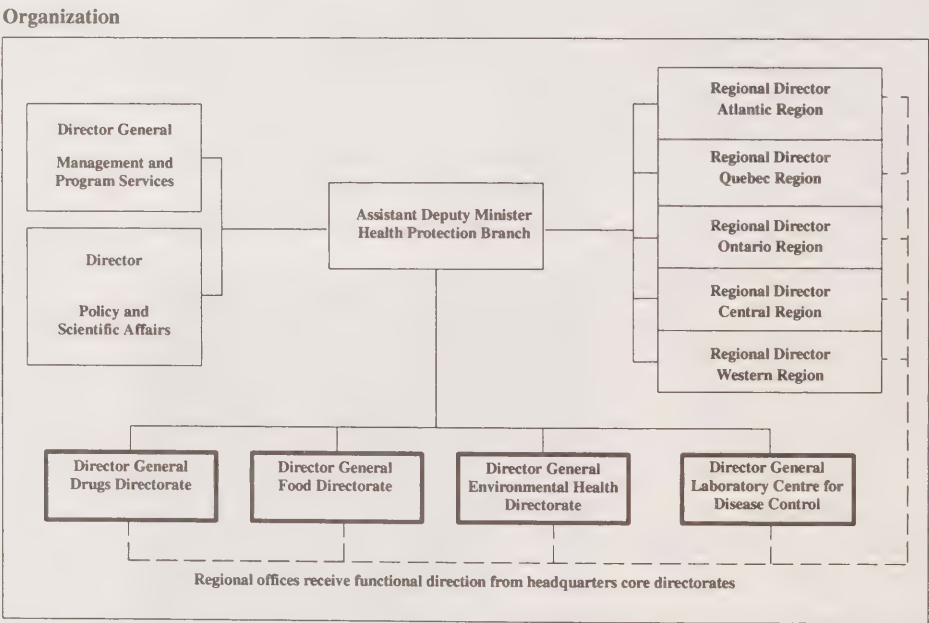
4.16 In response to continual requests to cut budgets, managers of the Branch became concerned that they would not be able to meet their obligations to Canadians to protect public health. They were particularly concerned about risks to health posed by new emerging diseases and technologies, such as the challenges presented by the emergence of new and more sophisticated biotechnology products. This is illustrated by their involvement in controversy surrounding public health issues such as the safety of

breast implants and the safety of Canada's blood supply.

4.17 During this period, a new Assistant Deputy Minister was appointed to the Branch. He and the senior management team were faced with the management dilemma of balancing conflicting demands from outside and within the Branch. There were the demands from Treasury Board and Health Canada to reduce expenditures. There were also the demands from experts within the Branch to protect and even augment the budget to maintain the scientific base, to continue existing

Exhibit 4.1

Health Protection Branch, Health Canada, Organization and Resources, 1994-95



Source: organization chart from the New Enterprise Manager's Information Kit

Resources

Branch FTEs 2,360	Drug Safety, Quality and Efficacy	Food Safety, Quality and Nutrition	Environmental Quality and Hazards	National Health Surveillance	Program Management	Total
000's of dollars	63,031	61,384	49,481	33,351	51,269	258,516

Source: budget and full-time equivalent (FTE) totals from the Health Canada 1994-95 Estimates, Part III

research, to reduce program gaps and to strengthen regulatory activities. They warned that today's cuts could be tomorrow's headlines.

Turning to Change Management

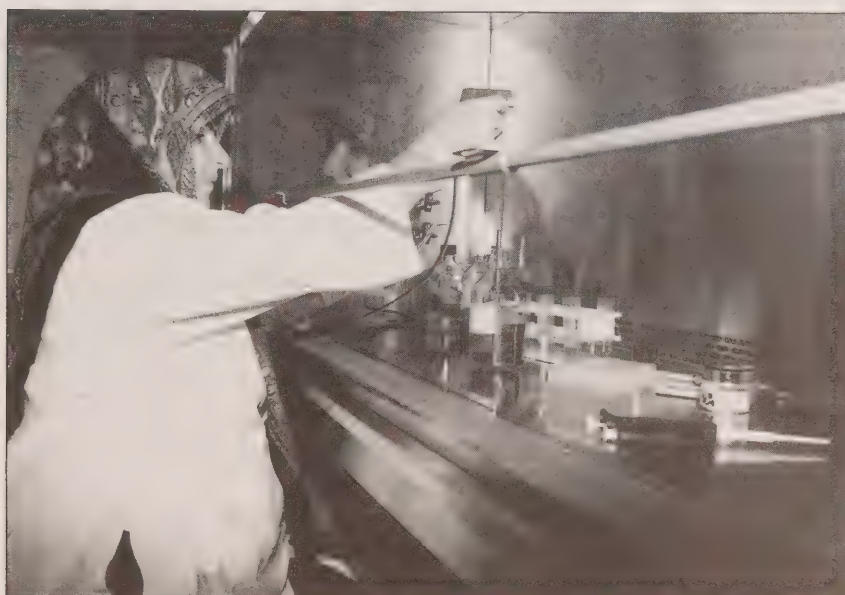
4.18 Senior Branch management rejected the idea of across-the-board cuts. Rather, to resolve conflicting demands, the Branch turned to program re-engineering. This change management process was to provide an objective basis for identifying, funding and meeting core obligations. A starting point in such a process would establish a clear understanding of the necessity for, and the costs and effectiveness of, the Branch's activities in core areas. Then, alternatives to existing methods in those core areas would be examined. Funding alternatives include identifying savings from increased efficiency, generating new revenues, and developing a more objective basis for allocating resources among competing regulatory, scientific and surveillance activities. A reallocation process based on assessment of public health risk provides a basis for changing traditional allocations.

4.19 The Department gave approval to Branch management to undertake a full and thorough examination of the Branch's legislated mandate, and its resources and activities. The process was originally focussed within government, building on stakeholder input obtained through previous studies. An additional requirement, made by the Deputy Minister of Health, was that the change process deal with known program problems in the areas of drugs and medical devices.

Audit Scope, Objectives and Criteria

4.20 Past studies of the Branch, including our 1994 audit of food safety, identified the difficulty of bringing about change quickly in the Branch. Branch management recognized the importance of moving ahead more quickly. The Branch was proactive in taking responsibility to make changes, and its self-initiated change process started more than a year before the government-wide review and its implementation. Government is demanding change both across government and within individual

Senior management rejected the idea of across-the-board cuts and turned to program re-engineering.



Recent developments in the biotechnology field challenge Health Protection Branch scientists in their role of protecting Canadians from health hazards (see paragraph 4.16).

We audited the Branch initiative early in the process to determine whether the experience could be of help to others who are being faced with similar pressures.

departments. Managers need to be prepared to meet these challenges and take necessary action. There is an increasing importance for government managers to be able to deal with changing conditions. The Health Protection Branch started early. We audited the Branch initiative early in the process in order to determine how well it was proceeding and to determine whether the experience could be of help to others who are being faced with similar pressures.

4.21 The overall objective of this audit was to assess the early successes of the change initiative, with a view to drawing some broader lessons learned on what appears to work in managing change in government. Specific sub-objectives of the audit included an assessment of:

- the reasonableness and completeness of the approach taken toward change;
- the identification of any early problems, obstacles or constraints that could limit the success of the New Enterprise initiative; and
- the progress achieved to date.

4.22 The scope of the audit included the initiation and implementation of the change initiative at Health Protection Branch from early 1993 to February 1995. Audit activities involved field work in the Branch in Ottawa and regional laboratories. The scope of the audit included management of the process, data gathering, analysis, development of action plans, and recent reviews of the Branch, whose recommendations were to be implemented through the change process. The audit excluded reviews in progress during the audit, such as plain packaging of tobacco products and the inquiry into the safety of Canada's blood supply.

Audit Criteria

4.23 There are a number of different management theories on how to effectively implement change initiatives. However, there is general agreement that successful change is characterized by:

- being taken seriously by senior management and being given the required time and resources;
- being guided by an articulated vision that provides a coherent focus on where the organization is going, as well as how it plans to get there;
- having clearly set out plans, objectives, milestones and personal accountability for delivering results;
- monitoring progress against plans, objectives and goals and making modifications as required; and
- maintaining commitment to the task.

4.24 Each organization must adapt and modify its approach and timing of implementation to reflect its own institutional circumstances, culture and operating environment. We assessed the reasonableness of the Branch's initial approach, given its unique circumstances, and we examined the results against targets established by the Branch to assess its progress.

Audit Observations

Starting the Change Initiative

4.25 The initial months were spent gathering program information for the initiative (see Exhibit 4.2). The first step taken by the Branch Assistant Deputy Minister was to put in place the resources required to manage the change initiative. Soon after the approval of the initiative, a core team was assembled. This team included a wide range of HPB personnel and staff from other branches of the

Department. An oversight committee was established to provide independent challenge and advice to the core team. This committee included the Branch Assistant Deputy Minister, the Senior Assistant Deputy Minister from Health Canada, and external experts including senior officials from the Treasury Board Secretariat and Privy Council Office.

4.26 The team's initial tasks were to gather data and conduct analyses for presentation to the oversight committee. The data on Branch activities were gathered as a result of a series of questions asked of managers. These questions were designed to provide information on the effectiveness of activities and the extent to which alternatives existed. This information was gathered, analyzed and presented to the oversight committee within a period of 13 weeks.

A quick response with a reasonable initial process

4.27 Senior management had been faced with conflicting demands and had responded quickly to the dilemma. The questions being asked of program

managers were important ones, in effect beginning a program review a full year ahead of the rest of government. The Branch was successful in marshalling the necessary resources and focussing them on the task in a timely fashion. The pace with which this process got under way created a degree of momentum that many of the participants view as having been important.

4.28 Senior management within the Branch played a visible leadership role and were seen by members of the core team as champions of the exercise. Many of the participants felt that the involvement of senior management contributed to a sense of enthusiasm and commitment among team members.

4.29 The composition of the oversight committee brought a degree of external pressure and support, which created a sense of urgency that helped maintain the initial momentum. Thus, the process got off to a quick start with the core team being able to present a considerable amount of information to the oversight committee within the time constraints imposed.

Senior management had been faced with conflicting demands and had responded quickly to the dilemma.

February 1993	HPB Program Review approved by Senior Assistant Deputy Minister
Spring 1993	Oversight Committee established
June 1993	Oversight Committee approved Data Collection Framework
July 1993	Risk exercise commenced with creation of Task Force
October 1993	Data Collection Framework Report presented to Oversight Committee
November 1993	Risk exercise presented to Oversight Committee
March 1994	Branch Executive Committee approved Action Plan
April 1994	Departmental Executive Committee approved Action Plan
15 April 1994	HPB unveiled the New Enterprise HPB restructured HPB Policy Framework introduced

Exhibit 4.2

Chronology of the First Phase of the Change Initiative at HPB

Some compromises were made and the success of some early efforts was mixed.

Data to conclude on effectiveness and related costs not always available

4.30 Some compromises were made and the success of some early efforts was mixed. The data actually gathered did not fully answer all the critical questions being asked. For example, results were often not measured and conclusions were not reached on whether objectives were being met. In addition, the effectiveness and related costs of activities, and alternatives to current activities, were often not addressed. This type of information is necessary to rationalize and systematize decisions in programming and in the allocation of scarce resources. The absence of much of this information provided a weak foundation for the Branch's efforts to assess public health risks and to rationalize budget allocation. This matter is discussed further in paragraphs 4.57 to 4.63.

4.31 The Branch should improve the data available on the effectiveness of its programs.

Department's response: Agreed. Health Protection Branch's shift from dependence on parliamentary appropriations toward greater reliance on cost recovery and client fees has emphasized the importance of cost effectiveness, service standards, program effectiveness and alternatives to current program delivery methods. The Branch has identified the capability to conduct the required analyses as a strategic priority and is devoting special efforts in this area. Models being developed will help to identify the type and quantity of data the Branch must generate.

Implementation of the New Enterprise

4.32 On 15 April 1994, the implementation plan, referred to as the New Enterprise, was announced to the

Branch with supporting action plans. These plans included a range of initiatives from relatively minor changes to broad changes such as a reorganization of the Branch structure. At the same time, the concept of "15 and 15" was introduced, which entailed:

- a 15-percent reduction in base expenditures within three years to meet expenditure reduction expectations and to provide a resource base for reinvestment; and
- another 15 percent of base expenditures generated by revenues within five years.

4.33 Key features of the plan were: developing a clear Branch policy framework, implementing significant changes to the organization and its accountability structure, fixing known program problems, focussing resources on core business and developing new approaches to the management of public health risks. Together these elements were key components of what management called the New Enterprise.

Reorganization to streamline accountabilities and structure

4.34 On the day that the New Enterprise was announced, the Branch was restructured. The Field Operations Directorate was disbanded and Regional Directors in the regions now reported directly to the Assistant Deputy Minister. Directorate heads for the core elements were given the full authority they needed to be made accountable for the core programs. Headquarters and regional staff of the Field Operations Directorate were integrated with the core program directorates. A directorate of management and program services was formed that included a program review office and a revenue generation and business planning office.

4.35 During the audit, we noted some expected transition issues, such as uncertainty as to who to call in Ottawa for specific functional advice, how to prepare budgets for 1995–96 on a new basis, and the roles and reporting relationships of district offices in the new organization. However, staff in the regions informed us that they viewed the new reporting structure positively, where Regional Directors now reported directly to the Assistant Deputy Minister.

4.36 In implementing this organizational change on the first day of the New Enterprise, management succeeded in giving the exercise considerable visibility. The impacts were felt immediately by the affected staff, which contributed further to the momentum created in the initial phase.

Publication of a policy framework to clarify direction

4.37 At the same time as the reorganization was announced, the Branch published a policy framework intended to provide a basis for decision making on a range of public health alternatives (see Exhibit 4.3). Changes under the New Enterprise had not yet been implemented in those areas; however, the framework was intended to clarify direction and aid the implementation process.

4.38 Developing the policy framework required the co-operation of all directorates in the Branch and its completion was seen by management as an indication of their success in developing a more co-operative and collegial management environment.

Management succeeded in giving the exercise considerable visibility.

The Policy Framework encompasses the Branch's role in the identification, assessment and management of risks to the health and well-being of Canadians. The Policy Framework involves the following key components:

- **Priority Setting:** to establish priorities for health issues on the basis of risk assessment and management and to establish goals in the priority areas
- **Risk Assessment/Risk Management:** to follow a structured process of risk determination for the assessment and management of risks
- **Regulatory Approach:** to use a flexible regulatory approach to permit responsiveness to changing circumstances
- **Internationalization:** to participate in the development and adoption of international health and safety standards to reduce health risks to Canadians
- **Communication:** to make decisions publicly accessible and to increase understanding among Canadians so they can improve their health
- **Co-operation:** to work in collaboration with stakeholders in the development and delivery of programs
- **Scientific Capacity:** to maintain the Branch's scientific capacity and to support research aimed at developing and maintaining measures for improving the health of Canadians
- **Management:** to provide clear direction and to support an environment that encourages excellence and to make best use of resources
- **Revenue Generation:** to identify opportunities for revenue generation while minimizing the negative impact on public health and providing an incentive for effective program delivery

Exhibit 4.3

The Health Protection Branch
Policy Framework, 1994

Much of the early momentum began to dissipate.

Other events diverted attention and energy from the implementation process.

Necessary building blocks in place

4.39 The process that had been set up provided visibility and momentum, and allowed action to begin. The early focus had been on putting in place what senior management saw as necessary building blocks: the people, the organizational structure and the policy guidance. What remained were the much more substantive and complex issues that dealt more directly with the management of public health risks.

A loss of momentum

4.40 Following the announcement of the New Enterprise on 15 April 1994, responsibility for implementing the specific action plans was given to operational staff. Much of the early momentum began to dissipate. The oversight committee was disbanded, and the core team members returned to their operational responsibilities. There was no longer a group dedicated solely to the change initiative.

4.41 In addition to staff having their ongoing responsibilities, other events diverted attention and energy from the implementation process. The government-wide program review had been announced in February 1994 and a considerable amount of effort was devoted to that exercise in the spring and summer. Consequently, implementation slowed. At the time of our audit, most of the individual action plans were behind schedule. The result is that the Branch has not yet been able to turn its full attention to many of the known program problems, or to fully develop its approach to the management of public health risks.

Slow Progress in Fixing Known Program Problems

4.42 In undertaking the change initiative, Branch management made a

commitment to include the implementation of solutions to problems in program operations. We examined in more detail the progress being made in the Drugs Directorate and the Medical Devices Bureau. In terms of known program problems, those two areas had been the subject of recent, high-profile studies that were explicitly referred to in the initiative's objectives.

Key issues still need to be resolved in the change initiative within the Drugs Directorate

4.43 The Drugs Directorate's objective is to protect and improve the health of Canadians through assessing the benefits and risks associated with the manufacture, sale and use of drugs and by taking appropriate action; promoting the scientific approach of risk-benefit assessment; and developing and disseminating information that encourages the rational use of drugs. Regulatory tools used by the Directorate include premarket analysis, postmarket surveillance and regulatory efforts to ensure compliance with good manufacturing practices.

4.44 Many of the program problems already known to the Branch were in the Drugs Directorate. The Directorate's capacity to deliver its mandate has been studied extensively during the past decade (see Exhibit 4.4). Common themes in these studies include the need to reduce the drug submission review backlog; to enhance the emergency drug release program; to streamline the drug approval process; and to enhance the risk-benefit management capacity.

4.45 In response to the most recent study (Gagnon Report), the Drugs Directorate had set up Drugs Directorate Renewal, which was intended to fix all known problems, including those identified by Gagnon. Drugs Directorate management developed a renewal strategy

Exhibit 4.4

Previous Studies of HPB's Drug Responsibilities

Year	Report	Commissioned/Conducted by	Common Themes
1985	Nielsen Task Force Program Review on Health and Sports Programs	Federal Government	<ul style="list-style-type: none"> backlog of drug submissions regulatory burden streamlined procedures for handling drug submissions should be implemented
1985	Report of the Commission of Inquiry on the Pharmaceutical Industry (Eastman Commission)	Federal Government	<ul style="list-style-type: none"> regulatory process for approval of new drugs is slow clinical testing slower than in other countries period required for the clearance of new drugs should be reduced
1987	Working Group on Drug Submission Review (Stein)	Federal Government	<ul style="list-style-type: none"> risks relative to the benefits of approved drugs need program strengthening problems with emergency drug approvals concerns about response/review times, backlogs deficiencies in regulatory framework drug submission review process is not performing in an efficient and timely manner
1987 1990	Audit of Department of National Health and Welfare	Office of the Auditor General	<ul style="list-style-type: none"> backlog of drug submissions inadequate system for emergency drug releases consideration of ways to streamline the review and approval process should be undertaken
1992	Gagnon Review of the Canadian Drug Approval System	Minister of National Health and Welfare	<ul style="list-style-type: none"> program enhancements are needed to the risk-benefit capacity of drugs exploration of international harmonization of the drug review system no structure for adverse drug reaction reporting backlog must be eliminated abridged drug submission schemes are proposed

There have been some achievements. However, key issues still remain outstanding.

that was approved by the Minister in August 1993. All projects are scheduled to be completed by August 1995. The strategy builds upon the recommendations of the Gagnon Report and other similar studies. As the renewal process was already in place, the objective of the change initiative, with respect to the Drugs Directorate, was to include implementation of Drugs Directorate Renewal.

4.46 There have been some achievements, such as the development of an electronic drug-tracking system and of interim performance standards for the review processes, and strengthening of the monitoring and surveillance system for adverse drug reactions. In addition, the assessment process has been streamlined for low-risk drug products. However, key issues still remain outstanding. For example, the assessment processes for other categories of drug products, including high-risk products, have not been streamlined. The Directorate has yet to implement improvements to the emergency drug release program.

4.47 All of the studies (see Exhibit 4.4) recommended that the backlog of drug submissions be reduced or

eliminated. Current Directorate efforts are improving the systems for managing drug reviews. The system, revised in November 1994, provides management with information on various categories of workload. However, there have been changes in the definition of an acceptable drug submission and the definition of a backlog. As a result, the new system cannot provide comparison with prior years, and it is not possible to determine the extent to which the backlog has been reduced. However, management has stated that backlog elimination will become the priority of the renewal program during 1995.

Not all changes for the drug program are within the Branch's control

4.48 Management believes that improvement of the backlog situation is dependent, in part, upon the success of efforts currently being made to implement cost recovery and to increase harmonization with other countries in regard to the drug review process. The harmonization process is proving to be time consuming and not entirely within the control of the Directorate. In addition, implementation of a number of the Drug Directorate Renewal projects is dependent

Exhibit 4.5

The Definition of a Medical Device under the *Food and Drugs Act*

The *Food and Drugs Act* ⁽¹⁾ defines a "device" as any article, instrument, apparatus or contrivance, including any component, part of accessory thereof, manufactured, sold or represented for use in:

- the diagnosis, treatment, mitigation or prevention of a disease, disorder or abnormal physical state;
- restoring, correcting or modifying a body function or the body structure;
- the diagnosis of pregnancy; or
- care during pregnancy and at and after birth.

Based on this definition, more than 450,000 device products in several thousand different product classes are known to be sold in Canada.

Examples of device products range from highly sophisticated computerized diagnostic equipment to simple wooden tongue depressors.

⁽¹⁾ Chapter F-27, Revised Statutes of Canada, 1985

upon the outcome of stakeholder consultations.

Medical Devices Bureau created but change is slow

4.49 The Medical Devices Bureau is responsible for maintaining information on all medical devices (see Exhibit 4.5) for sale in Canada; premarket review of high-risk devices, postmarket surveillance of existing devices; research into device hazards; and the development of regulations, standards and test methods.

4.50 As was the case with the Drugs Directorate, the Hearn Report had identified a large number of program weaknesses relating to medical devices. The Hearn Report, commissioned by the Minister of Health and Welfare to report on the regulation of medical devices, was published in 1992 and reported that major changes were essential to the efficient and effective regulation of medical devices.

4.51 Some progress has been made. The establishment of the Medical Devices Bureau was in response to the Hearn Report. There is now clearer accountability for medical devices, aided in part by the Branch reorganization in 1994. New operating procedures have been developed, which are expected to be finalized for approval by Branch management by the summer of 1995. Also, a risk-based classification system was developed by September 1994, which will be used as a framework to develop regulations and conformity assessment procedures with the objective of international harmonization.

4.52 However, key issues remain to be addressed. Many important regulatory issues remain outstanding and will not be dealt with fully until a proposed regulatory package is implemented. This package comprises proposed changes in

16 different areas, including a need to strengthen requirements for manufacturers to demonstrate safety and effectiveness prior to marketing a device. The Branch expects the package to be implemented by 1997.

Necessary regulatory change for medical devices depends on processes outside the Branch

4.53 Some medical devices are categorized in the regulations as being of high risk (for example, long-term implantable devices), that is, their use can cause serious injury or death. The regulations require that clinical trials must be conducted to the satisfaction of the Medical Devices Bureau prior to approval being given for the use of these high-risk devices.

4.54 For those devices not listed in the regulations as being high risk, premarket approval is not required and action can be taken by the Bureau only after the device has already been marketed. Few changes have been made to this list since 1985. Therefore, many new devices that the Bureau views as being high risk are not subject to premarket approval and will not be treated as being high risk until the regulations are changed.

4.55 The Branch recognized in 1985 that regulatory change was necessary in the area of clinical trials, and began work on proposed regulatory amendments. Due to considerable resistance encountered during the stakeholder consultation phase, the Branch did not succeed in obtaining approval for the proposed amendments. The Branch recognizes that only the implementation of a risk-based classification system through new regulations will truly give the correct focus on high-risk devices. A new set of amendments is being developed and

management hopes that these will obtain the necessary approval before 1996.

4.56 Our assessment was carried out early in the implementation phase of the New Enterprise. As part of the process, work in fixing known program problems is ongoing.

The Development of an Approach to the Management of Public Health Risks

4.57 Attention was also given early in the process to analyzing the fundamental problems that caused the change initiative in the first place; in particular, identifying priority public health risks and finding funding solutions that would allow the Branch to meet its obligations in protecting Canadians against these risks. Managers were concerned about the Branch's ability to meet its obligations to protect public health. A new approach to the management of public health risks was seen by management as critical in being able to meet these obligations. Such an approach would elaborate the new policy framework and help develop a resource allocation model. It would bring together information on the relative importance of present and emerging public health risks, and on the most cost-effective interventions to manage these risks; and it would result in a set of health protection priorities.

4.58 The individual directorates monitor environmental, food and drug threats. In addition, the Laboratory Centre for Disease Control plays a central role in gathering and disseminating public health intelligence. Building on this information base, in July 1993 the Branch created a task force to develop a scientifically objective method of ranking Branch activities in terms of public health risk.

The task force results did not support change

4.59 The task force first identified 49 public health issues for which the Branch had a mandate. The issues were ranked, using a methodology that assumed that the Branch operated in isolation and that no other programs existed elsewhere in other jurisdictions to manage the risk. In ranking the issues, consideration was not given to characteristics of the population such as age, sex and socio-economic status. Nor were currently accepted methods for assessing levels of risk used.

4.60 None of the risks received a low ranking. Although some were ranked as medium, the vast majority were determined to be in the high-risk category. The resulting analysis therefore essentially confirmed the status quo. The risk assessment, evaluation and ranking exercise can be significantly improved by addressing the foregoing limits imposed on the exercise. Public health experts use risk ranking and priority setting in several ways in environmental health, food and drug safety, and disease prevention and control. These techniques are widely used and well described in the professional literature. The magnitude of risk can usually be estimated from data collected in epidemiologic and toxicologic studies.

The need to improve the approach to the management of public health risks

4.61 For the risks identified, the Branch was unable to relate these back to current Branch resources used to manage the risk. As well, the initial data collection exercise was constrained by the lack of information on the effectiveness of many of the Branch's scientific and regulatory activities. As a result, the model could not fully address the question of the effectiveness and related costs of the range of public health interventions anticipated in the Branch's new policy,

The risk assessment, evaluation and ranking exercise can be significantly improved.

A new approach to the management of public health risks was seen by management as critical.

which stipulates that priorities and courses of action be on the basis of sound risk assessment and risk management.

4.62 As the core of scientific expertise within the Department, the Branch plays a unique and important role in providing health intelligence to senior departmental decision makers. The Branch should continue with the development and implementation of a new approach to the management of public health risks, as well as ensuring that it is updated on a periodic basis. This will provide an important analytical tool to support informed Branch-wide resource allocations, based on scientific risk and the effectiveness and related costs of different public health intervention strategies.

4.63 The Branch should complete the development of its approach to the management of public health risks for use in allocating the Branch's resources and setting Branch priorities.

Department's response: The Branch recognizes the limitations of the priority-setting system and is addressing the issue. The health issues priority-ranking model was recognized as a first attempt to rank health issues in an objective way, based on risk assessment and risk management criteria. The Branch plans to complete the development of this model, for use in allocating its resources and setting its priorities. This is a key component of Health Canada's plans to strengthen its evidence-based approach to priority setting and risk management throughout the Department.

The Search for Alternative Methods of Funding

4.64 At the time the program review was initiated in early 1993, it was clear to departmental senior management that they needed to explore ways to reduce reliance on parliamentary appropriations. Greatest

priority was given to generating revenue through cost recovery or savings from more efficient operations.

Limited success with cost recovery in the past

4.65 As illustrated in Exhibit 4.6, the Branch has generated some revenue through cost recovery and user fees for some time. However, revenue generation had not been given much emphasis. For example, in 1974 the Branch's Radiation Dosimetry Services adopted a policy of partial cost recovery. Yet, not until the advent of the New Enterprise in 1994 were the costs of these services fully recovered (\$2.6 million in 1994-95).

4.66 In 1985, the Nielsen Task Force Report identified cost recovery opportunities of approximately \$7 million annually for the premarket evaluation of drugs and medical devices. Three years later, Treasury Board directed the Branch to implement a cost recovery program by January 1989 for premarket evaluation of drugs. However, the Branch was unable to reach an agreement with stakeholders on the implementation of cost recovery. As a result, the Branch could not obtain the approval required from Treasury Board Ministers.

Revenue generation targets set in the New Enterprise revenue plan

4.67 One of the features of the New Enterprise was that the Branch would no longer be solely dependent on government appropriations for the resources to carry out its business. The New Enterprise proposed an annual revenue goal of 15 percent of its base budget, within five years. At that time, the Branch estimated potential revenues of \$28 million.

4.68 At the same time, the Assistant Deputy Minister set up a revenue generation and business planning unit.

It was clear to departmental senior management that they needed to explore ways to reduce reliance on parliamentary appropriations.

This unit developed a revenue plan, with specific revenue generation opportunities. It identified 18 different activities currently performed by the Branch where user fees could be implemented between 1994-95 and 1997-98. The plan estimated potential gross revenues of \$90 million over the three-year period, with an initial outlay of \$35 million.

4.69 A Branch policy was developed, consistent with government policy. To implement the policy, comprehensive authority to prescribe fees for services, rights and privileges was requested. However, this comprehensive authority was not approved; rather, approval was given only for regulations for setting fees for the annual renewal of drug

registration, which is necessary to sell a drug in Canada.

Speed of progress in implementing revenue generation influenced by processes outside the Branch

4.70 For 1994-95, the Branch estimates that revenue to be generated in the last quarter of the fiscal year from approvals for selling drugs will be \$5.5 million. The Branch does not have the authority for vote-netting this revenue, which means that it will not be available for reinvestment. The authority for vote-netting is being sought from Treasury Board.

4.71 For the other revenue generation initiatives, the Branch will again have to

Exhibit 4.6

History of Revenue Generation at HPB

1974	Radiation Dosimetry Services – policy of partial cost recovery was adopted by the Branch.
November 1985	Nielsen Task Force on Program Review recommended a fee-for-services approach for the evaluation of new drugs, drug products and medical devices.
July 1988	Treasury Board directed a cost recovery program to be implemented by 1 January 1989 for premarket evaluation for drugs.
October 1988	A study on ways and means to increase cost recovery started in 1988 (completed in 1991; no action was taken).
1991	Delays reported in implementing cost recovery for premarket evaluation of drugs (Auditor General).
1 April 1994	Radiation Dosimetry Services – full cost recovery was implemented.
15 April 1994	The New Enterprise set revenue generation goal.
1994	Government-wide cost recovery opportunities of up to \$200 million from the federal food safety system (Auditor General).
December 1994	The Branch promulgated a Cost Recovery and Client Fee Policy. Regulation approved prescribing fees to be paid for the right and privilege to sell a drug. Branch estimates revenues of \$5.5 million in last quarter of 1994-95.

go through the government approval process. In addition, consultations are required with affected stakeholders. These parts of the process, external to the Branch, add to the time required to implement revenue generation initiatives.

4.72 At the completion of the audit, revenue generation was at the early stages of implementation. The Branch has made progress in an area where, in the past, very limited progress had been made. For at least a decade, the Branch had been reluctant to implement revenue generation initiatives. When the change initiative began, the Branch's scientists and other professionals identified few revenue generation opportunities. Early targets have now been significantly increased. The Branch now projects opportunities of over \$130 million, over a three-year period.

4.73 Contributing factors to this initial success include the commitment of senior management to achieving revenue targets, monitoring of results by senior management, and a dedicated core team with few other responsibilities, other than revenue generation. While the change initiative was effective within the Branch, the requirements outside the Branch will influence its ability to achieve its targets.

Efficiency savings identified

4.74 The objective of the New Enterprise was to manage a 15-percent reduction in expenditures within three years. This would allow the Branch to meet future government cuts and to provide a resource base for reinvestment. When the data collection exercise was initially conducted and individual action plans prepared, approximately one third of the plans identified opportunities for potential cost savings. As well, areas of additional investment were identified.

4.75 The Branch is in the process of streamlining some activities where savings were expected. It reports that savings will be realized in the later part of the three-year period. In 1994-95, cost savings of about \$2 million have already been realized by consolidating and restructuring certain directorates and by renegotiating the Branch's facilities management agreement with Public Works and Government Services Canada.

Plans will be revised to include more savings following program review

4.76 The planned rate of change to achieve these savings and the reinvestment objective of the New Enterprise was given greater emphasis by the government-wide program review. Significant reductions are being demanded from the Branch's operational expenditures. Once the program review is over, the Branch anticipates it will be in a better position to amend its plan to realize efficiency savings. To date, the Branch has made some initial cost savings. However, larger savings were demanded by government-wide reductions than resulted from the New Enterprise.

4.77 Senior management of the Branch believe that the New Enterprise experience has better prepared them to meet the further demands of fiscal restraint. The knowledge that Branch managers gained in developing the New Enterprise put them in a better position to make the quick trade-off decisions required to deal with the further reductions in appropriations.

Budget reallocation still to be considered

4.78 At the beginning of the change initiative, senior Branch managers were faced with the dilemma of balancing conflicting demands, from outside and within the Branch, on required resource

To date, the Branch has achieved some initial cost savings. However, larger savings were demanded by government-wide reductions than resulted from the New Enterprise.

Many of the pressures that gave rise to the initiative still exist.

levels. The Branch intended to develop a process for reallocating resources based on assessment of public health risks. This process would be used to ensure that the Branch funded only activities that contributed directly to its core business.

Public Health Intelligence System

4.79 At the completion of the audit, the Branch demonstrated that it had the capability to find funds for important new activities such as the Health Intelligence System (see Exhibit 4.7). These funds will come from existing resources within the Branch and the Department. However, as described in paragraphs 4.57 to 4.63, the absence of a robust approach to the management of public health risks contributed to limited progress in developing a new resource allocation model. Essentially, the Branch is still working with the priorities and resource allocation approaches that existed at the inception of the New Enterprise.

Conclusion

4.80 The New Enterprise was developed and implemented to help

management deal with the dilemma of increased uncertainty in funding levels, given the existing and new demands for greater program expenditure. Past studies had pointed to the need for significant improvement in existing core activities such as drugs and medical devices. Branch management took reasonable and responsible action in launching the change initiative to deal with these challenges. As our audit has shown, many of the pressures that gave rise to the initiative still exist; budget pressures are even stronger and significant known program problems still need to be addressed.

4.81 The initiative, as initially launched, was a reasonable one. It was taken seriously by management, who devoted time and resources to it in the early stages. A vision of what the Branch was trying to achieve was articulated. Plans were put in place and accountability clarified. The process resulted in a number of early achievements such as organizational changes, development of Branch policy and improvements to internal systems. However, there was difficulty obtaining the effectiveness information required and developing a new approach to the management of public health risks. These areas need attention to provide the basis for moving forward in implementing changes envisioned in the New Enterprise.

4.82 From the beginning, it was a process designed for and by the Health Protection Branch. By definition, the process was limited to activities under the Branch's own control. The greatest success was with those processes that were strictly under the control of the Branch and dealt more with administrative than program matters. Success on the program side will require sustained effort as part of the New Enterprise.

Exhibit 4.7

Strengthened Public Health Intelligence System

Objectives

- monitoring trends of new and emerging infections
- investigating disease outbreaks
- assessing health risks
- disease prevention and control

Activities

- providing health intelligence where virtually none exists (e.g. blood-borne pathogens)
- improving health intelligence where little exists (e.g. infectious respiratory diseases)

Funding

- \$7.1 million in 1995-96
- increasing to \$10.8 million per year in 1997-98

4.83 The momentum of the early successes was not sustained throughout the implementation of the New Enterprise. Other events, such as the government-wide program review, diverted the attention of management. In addition, the pressure exerted by the oversight committee was removed. The oversight committee not only served as a vehicle for discussing issues with experts from central agencies and senior managers in the Department, but also provided an effective accountability forum to monitor progress and discuss possible changes. Once implementation began, early momentum was lost. The Branch needs to explore ways of rekindling some of the early pressure and enthusiasm of the change process. The New Enterprise would benefit from continued review and scrutiny by some form of senior committee.

4.84 The change initiative at the Branch provides some insights or possible lessons for other managers in government facing similar pressures for change. The experience of the Branch points to the importance of managers being proactive. Government managers face many demands from inside and outside their organizations for change in programming and budget requirements. By having initiated their own review process, managers in HPB were better positioned to meet the requirements of the government-wide program review and still be in a position to deal with Branch priorities. This ability to respond became even more important given the demands for continuous change and adjustment.

4.85 The Health Protection Branch experience also demonstrates the importance of getting off to a good start. Management marshalled the resources to initiate the process and focus the effort. Senior management provided leadership

and support to the process. An oversight committee that included managers outside the Branch provided objectivity and credibility through its review of progress being made. Plans and objectives were set and dedicated teams were established to address priority areas. Although the Branch suffered some loss of momentum, this momentum could be regained by revisiting some of the early success factors.

4.86 The Branch's experience reinforces the importance of the availability of information on program results. Managers wanted to build their change initiative on sound information. However, the information they wanted on the effectiveness of their programs and assessment of public health risks was not always available. If this type of information is not available at the initiation of a change process, it needs to be collected as part of the change process in order to make the right program decisions and measure progress being made.

4.87 Managers at HPB were often overly optimistic in the targets they set themselves. Their experience points to the importance of recognizing the time and effort needed to bring about some of the planned changes while continuing to meet the normal job requirements. As managers at HPB found, their existing obligations brought new and unanticipated demands. For example, the Krever Commission on the safety of Canada's blood supply and the government-wide program review consumed energy and resources that would otherwise have been applied to the change process.

4.88 The experience of the managers at the Health Protection Branch also points to the difficulty of maintaining the momentum of a change process. Other events can shift the focus away from the

The change initiative at the Branch provides some insights or possible lessons for other managers in government.

The Branch's experience points to the continuous effort required to bring about change.

The challenge for government will be finding ways to accommodate government-wide requirements while supporting initiatives in smaller units of government.

change agenda. For HPB, many important areas still remain to be addressed. For change to succeed, senior Branch managers recognize the importance of monitoring progress on actions, making management and staff accountable for results and maintaining the commitment to change and innovation, despite other pressures.

4.89 The Branch's experience underlines the continuous effort required to bring about change. Success in identifying opportunities for cost recovery resulted not only from pressure from Treasury Board and the government-wide program review but a commitment from all program managers to identify those opportunities. For ongoing change to take place, it needs to be part of day-to-day management and part of the organizational culture.

4.90 Managers at the Health Protection Branch are making progress in changing their own processes. However, they operate within a broader system of rules and procedures, for example, issues related to revenue generation and regulatory reform. Key parts of the progress expected from the New Enterprise will be determined by existing processes outside the Branch. The Branch managers perceive that they are being asked to carry out "new initiatives with old rules." From the perspective of the central agencies, necessary rules and procedures are required to fulfil their obligations under legislation.

4.91 The challenge for government will be finding ways to accommodate government-wide requirements in areas like cost recovery and regulatory approval, while supporting initiatives in smaller units of government such as the Health Protection Branch.

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HEALTH CANADA - OUR MISSION

To help the people of Canada maintain and
improve their health

Mr. Denis Desautels
Auditor General of Canada
240 Sparks Street
Ottawa, Ontario
K1A 0G8

Dear Mr. Desautels:

I have reviewed the chapter "Health Canada - Management of the Change Initiative at Health Protection Branch" and find that it paints a positive and constructive picture of the manner in which one important component of the Department anticipated the now Government-wide requirement for change and re-engineering in the Public Service. This chapter presents a useful analysis of many of the lessons which can be drawn from our experience.

Health Canada believes that the quality of the Program Review team members which was assembled by the Health Protection Branch was one of the key reasons for its success. I believe that this is a lesson which must be reinforced for other public sector managers planning to embark on similar change management initiatives: the success of the initiative is directly dependent on the calibre of the team assembled to conduct the development of the approach, the collection and analysis of the data, and the formulation and presentation of change proposals.

.../2

Being audited at an early stage in the change process was a challenging experience and I believe that your description of the lessons learned will be beneficial. Your report should help us regain the momentum for implementing the necessary changes in carrying out the mandate of the Health Protection Branch and strengthening linkages between the health protection and other Departmental programs.

Yours sincerely,

Michèle S. Jean
Michèle S. Jean

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Chapter 5
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– Deposit-Taking Institutions Sector

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 5
Office of the Superintendent of Financial Institutions
– Deposit-Taking Institutions Sector



May 1995

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Chapter 5

**Office of the Superintendent of
Financial Institutions**

Deposit-taking Institutions Sector

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Office of the Superintendent of Financial Institutions

Deposit-taking Institutions Sector

Main Points

5.1 The financial services industry has undergone significant change in recent years. Some members have remained strong; several others faced significant difficulties and some did not survive. How well has the Office of the Superintendent of Financial Institutions (OSFI), and the regulatory system overall, done at ensuring the safety and soundness of deposit-taking institutions while meeting the government's objectives? We did not find a satisfactory answer to this question. Although the February, 1995 White Paper deals with several of the related issues, a comprehensive evaluation of the system's effectiveness is required.

5.2 There are certain structural weaknesses in the regulatory system. OSFI's mandate is not stated in one statute. The responsibilities of OSFI, the Canada Deposit Insurance Corporation (CDIC) and the Department of Finance for public policy objectives such as stability and competitiveness of the financial system are unclear. And the Department of Finance has not set out in clear terms how it ensures proper functioning of the regulatory system.

5.3 Accountabilities of the key players in the federal regulatory system are not defined well enough for them to measure and report on their performance. Regulatory processes need to be more transparent and OSFI needs to disclose, to the extent possible, more information about its handling of financial institutions. It should also consider providing to institutions information on best practices in the industry and peer group comparisons.

5.4 OSFI and CDIC responsibilities overlap in several areas. While some overlaps may provide useful checks and balances, others that are judged to be counterproductive should be either eliminated or managed better. Both organizations are making serious efforts to improve co-ordination.

5.5 OSFI must ensure that it is equipped to handle the challenges of the future, as the financial services industry continues its rapid evolution. In particular, OSFI needs to shift some of its emphasis from annual examinations to periodic monitoring of institutions, as their circumstances can change rapidly in this dynamic industry. OSFI should also clarify its expectations in respect of corporate governance in financial institutions and give ongoing attention to studying areas of system-wide risk, such as financial conglomerates and securities activities.

5.6 OSFI's supervisory processes have improved over time, but further significant work needs to be done. For dealing with troubled institutions, OSFI needs to strengthen its processes used to support the exercise of discretionary powers and the development of comprehensive action plans to ensure that remedial measures are taken promptly. In addition, specialized risk areas should be examined in more depth; examination methodology is still developing; post-examination quality control reviews and post-mortem analysis need to be upgraded; and further attention needs to be given to strengthening skills, training and experience of the examination staff.

5.7 OSFI has several important opportunities to achieve organizational efficiencies. Its examination, monitoring and policy functions remain largely separate and distinct between the deposit-taking institutions sector and the insurance sector, while there is increasing integration of these sectors in the financial services industry.

Background

5.8 The financial services industry plays a critical role in the Canadian economy. It is a major employer, accounting for about 4 percent of all working Canadians, and contributes around 7.5 percent of the gross domestic product (GDP). It also acts as the primary allocator of capital and credit, by intermediating between savers and borrowers. The financial sector's importance to regulators reflects the fiduciary nature of most activities of financial institutions. It also reflects the critical role played in the payments system by deposit-taking institutions, by far the largest component of the financial services industry.

5.9 Since the mid-1980s, many difficult challenges have confronted the financial services industry and regulators, supervisors and policy makers in most industrialized countries, including Canada. Globalization of financial services, volatile domestic and international markets and capital flows across borders are some of the challenges. Others include the use of complex financial instruments, breaking down of barriers between different kinds of financial institutions, and the communications revolution. Activities of financial institutions that generate fee income, including derivative products, have acquired greater significance.

5.10 These major market changes, coupled with deteriorating commercial real estate values domestically and internationally, have meant significant adjustments for the Canadian financial services industry. Many of the adjustments were painful and costly for deposit-taking and other institutions and, in some cases, led to their failures or distress sales. Since 1987, depositors and

creditors have lost hundreds of millions of dollars in failed and merged institutions. Moreover, the users of financial services will likely bear the brunt of higher deposit insurance premiums and other costs.

5.11 Despite these market stresses and financial losses, public confidence in the financial services industry has been maintained: total deposits in deposit-taking institutions and volumes of financing in the capital markets have grown steadily. Canada has several large, well-diversified financial institutions that compete both domestically and internationally, including five banks ranked among the world's top hundred in terms of total capital.

Objectives of the Federal Regulatory System for Deposit-taking Institutions

5.12 The present federal regulatory and supervisory system (hereinafter called the regulatory system or regulatory framework) has its roots in the 1966 revisions to the *Bank Act* and the 1967 *Canada Deposit Insurance Corporation Act (CDIC Act)*. These were designed to protect "unsophisticated" depositors from losses, maintain public confidence in the banking system and encourage competition in the financial services industry.

5.13 In the aftermath of the failure of two Western Canadian banks in the mid-eighties, there was a flurry of government discussion papers and independent reports on the circumstances of the failures. These culminated in the federal government's 1986 policy paper, "New Directions for the Financial Sector". This paper enunciated several principles, which subsequently formed the basis for most of the legislative changes in 1987 and 1992. These principles included ensuring the soundness of financial

Despite market stresses, public confidence in the financial services industry has been maintained.

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160 financial
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**OSFI is but one player,
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in the regulatory
framework for
deposit-taking
institutions; others are
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Bank of Canada.**

institutions and the stability of the financial system. In support of its 1992 legislation, the government released a paper giving an overview of the legislative proposals. This paper contained objectives of the legislation, which were to:

- benefit consumers by increasing competition and the variety of services offered by financial institutions;
- enhance protection for depositors and policyholders;
- strengthen the ability of Canadian financial institutions to compete at home and abroad; and
- lay the groundwork for discussions with the provinces on harmonization.

5.14 The 1987 and 1992 legislative changes established the new federal regulatory framework. The Office of the Superintendent of Financial Institutions (OSFI) was established with powers to enforce compliance, and new powers were given to the Canada Deposit Insurance Corporation (CDIC).

5.15 Toward the end of our audit, the government tabled in the House of Commons, on 9 February 1995, a White Paper entitled "Enhancing the Safety and Soundness of the Canadian Financial System". It deals with an early intervention framework, greater disclosure of financial data, changes to deposit insurance, and initiatives to reduce risk in the clearing and settlement system. The policy proposals outlined in the White Paper will be the subject of consultations with interested parties and will then ultimately be incorporated in a bill to be debated in Parliament. We have identified relevant proposals in the White Paper in different sections of the chapter to indicate the extent (and manner) to which the White Paper proposes to deal with the issues raised by us.

Federal Players in the Regulatory Framework for Deposit-taking Institutions

5.16 Office of the Superintendent of Financial Institutions. OSFI is but one player, albeit a principal one, in the regulatory framework for deposit-taking institutions; others are CDIC, the Department of Finance and the Bank of Canada. Throughout this chapter, we use the term "government" when referring to more than one of these players, together with other central agencies as appropriate. OSFI regulates and supervises banks; federally regulated trust, loan, insurance and investment companies; and federally licensed or registered co-operative credit societies. It also oversees federally regulated pension plans of the private sector and provides actuarial services and advice as required under various statutes. It examines and monitors financial institutions for financial soundness and compliance with legislation. In 1994, the consolidated assets of deposit-taking institutions and investment companies supervised by OSFI amounted to \$904 billion, representing an increase of 38 percent since 1989. Over 83 percent of those assets are held by domestic banks. OSFI's deposit-taking institutions sector supervises 160 financial institutions and has 130 employees.

5.17 Other players. In addition to providing deposit insurance, CDIC has certain regulatory responsibilities: it establishes and promotes standards of sound business and financial practices. It also has a statutory mandate to promote and contribute to the stability and competitiveness of the financial system in Canada. CDIC provides deposit insurance to both federally regulated and provincially regulated deposit-taking institutions. The Department of Finance develops policy and related legislative

proposals on the financial services industry and has broad responsibility for the workings of the regulatory and supervisory regime. The Bank of Canada acts as a lender of last resort and has certain responsibilities for the functioning of the payments system (Exhibit 5.1).

Progress Made by OSFI

5.18 The significant evolution in the financial services industry, coupled with the recent severe recession in Canada, created some difficult challenges for the federal regulatory system. Since 1987, seven federally regulated deposit-taking institutions have failed, representing over \$14 billion in insured deposits. There have also been several major takeovers of trust companies by large, widely held domestic banks.

5.19 Monitoring and dealing with the problems of financial institutions under stress has taken a great deal of OSFI's time and effort. In the same period, it had to develop a framework for risk assessment and risk management and the necessary human resource infrastructure to carry out its statutory duties. Since 1987, OSFI has made considerable progress in meeting these challenges. It established a more direct presence among deposit-taking institutions by adding the examination and monitoring of banks to its activities in Toronto and other regions. Its senior management started making contacts more frequently with the boards of directors of institutions. It introduced examination guides to reinforce the work of examiners. A portfolio approach to regulatory activities has been adopted, giving examiners direct responsibility for examination, analysis and monitoring. Three separate examination units -- for Schedule I banks, Schedule II banks and trust and loan companies -- were integrated to introduce more consistent

methodology. The examination process has placed more emphasis on risk assessment, and examination and liaison approaches have been systematized. In addition, OSFI has played an important advisory role in developing policy on financial institutions and in formulating legislation to reflect that policy. Similarly, it has been an active participant in the activities of the Bank for International Settlements concerning bank supervision, and in those of the Canadian Institute of Chartered Accountants in setting accounting and auditing standards for the financial services industry.

5.20 The above indicates that OSFI has made progress on several fronts. Most of the observations contained in our 1990 value-for-money audit have been acted upon. The ones where action has been slow include processes for handling troubled institutions, monitoring and specialized areas of risk.

Audit Objectives and Scope

5.21 We audited the deposit-taking institutions sector of OSFI to determine if:

- it has a clear accountability framework;
- it has adequate systems and procedures to assess and manage risks in deposit-taking institutions; and
- it has adequate systems, procedures and other capabilities to deal with changes in the financial services industry.

5.22 We also reviewed the relationships among the principal players in the federal regulatory framework to see whether their mandates in respect of the framework are clear and their operational linkages adequate to discharge their accountabilities.

Significant evolution in the financial services industry, coupled with the recent severe recession in Canada, created difficult challenges for the federal regulatory system.

OSFI has made progress on several fronts.

Exhibit 5.1

**Synopsis of Responsibilities
of the Federal Players in the
Regulatory Framework for
Deposit-taking Institutions**

Responsibility	OSFI	CDIC	Department of Finance	Bank of Canada
Implementation of public policy objectives: <ul style="list-style-type: none"> • Consumer protection • Stability and competitiveness of financial system • Public confidence in financial system • Harmonization of federal and provincial regulatory policies 	<p>*</p> <p>*</p>	<p>*</p> <p>*</p>	<p>*</p>	
Co-ordination mechanisms: <ul style="list-style-type: none"> • Financial Institutions Supervisory Committee (FISC) • Senior Advisory Committee (SAC) • Canada Deposit Insurance Corporation (CDIC) Board of Directors • Strategic Alliance 	<p>*</p> <p>*</p> <p>*</p> <p>*</p>	<p>*</p> <p>*</p> <p>*</p> <p>*</p>	<p>*</p> <p>*</p> <p>*</p>	<p>*</p> <p>*</p> <p>*</p>
Supervision of deposit-taking institutions: <ul style="list-style-type: none"> • Conducting statutory annual examinations¹ • Monitoring 	<p>*</p> <p>*</p>	<p>*</p>		
Handling of troubled institutions: <ul style="list-style-type: none"> • "Watch list" criteria² • Measures to enforce compliance • Provision of liquidity support³ • Going-concern solutions⁴ • Liquidation of failed institutions • Taking control of an institution • Reporting on a troubled institution to the Minister of Finance 	<p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p>	<p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p> <p>*</p>		<p>*</p>
Best management practices in deposit-taking institutions: <ul style="list-style-type: none"> • Promotion of standards of sound business and financial practices⁵ • Guidelines to institutions 	<p>*</p>	<p>*</p>		
Setting up business: <ul style="list-style-type: none"> • Regulatory approval • Issuance of deposit insurance policy 	<p>*</p>	<p>*</p>		
Canadian Payments Association (CPA): <ul style="list-style-type: none"> • Oversight of clearing and settlement system • Review of compliance with the CPA Act 	<p>*</p>			<p>*</p>

1 The Bank of Canada may require that the Superintendent perform, for a specified purpose, an inspection of any financial institutions within the meaning of the *Office of the Superintendent of Financial Institutions (OSFI) Act*.

2 OSFI and CDIC have separate "watch list" criteria.

3 Bank of Canada may provide last resort short-term financing to overcome liquidity problems.

4 OSFI has no mechanism to provide financial assistance.

5 In conducting examinations on behalf of CDIC, OSFI reviews adherence to the standards.

5.23 We did not audit the insurance and pensions sectors of OSFI. They will be covered in separate audits to be reported later. A special examination of CDIC was completed recently, pursuant to the requirements of Part X of the *Financial Administration Act*. The examination report has been submitted to the Corporation's Board of Directors. Although OSFI was the prime focus of our audit, the chapter contains certain observations on the Department of Finance and CDIC.

Observations and Recommendations

Weaknesses in the Federal Regulatory System Need Attention

Is the Government Achieving Its Objectives for the Financial Sector?

5.24 We did not find a satisfactory answer to this question. The Department of Finance has, in the past, produced several policy papers and reports dealing with different aspects of the regulatory framework. Some of these documents were in response to problems identified in specific financial institution failures, while others dealt with issues arising out of the changing financial environment. However, there has been no comprehensive evaluation of the regulatory framework to see whether it has been effective in meeting the objectives noted in paragraph 5.13. A comprehensive evaluation can be defined as a disciplined assessment of a government program or activity, based on systematic measurement and analysis of its continued relevance, success in

achieving objectives, and cost effectiveness compared to alternatives. In a September 1994 background document submitted to the Senate Committee on Banking, Trade and Commerce, the Department of Finance reviewed the 1992 legislative changes and concluded that "two years is too early for a comprehensive assessment of the relative success of the 1992 reform exercise as the impacts of structural initiatives of this nature are generally felt over time as the industry adapts to the new legislative environment."

5.25 While two years may be too short a basis to evaluate the 1992 legislative changes, certain fundamental principles and objectives have been enshrined in the legislation for many years. They need to be evaluated to see if they are still valid and if performance has met expectations. Long-standing government objectives include maintaining and promoting stability in the financial system, protecting "unsophisticated" depositors from loss and encouraging competition in the financial services sector. There are additional objectives that are not part of legislation but have been included in policy statements of the government. These include maintaining public confidence in the financial system and harmonizing the federal regulatory framework with those of the provinces.

5.26 The increasing concentration in the financial services industry since 1987 reflects the major banks' ownership of securities, trust and loan companies, and invites questions from the Canadian public about the impact on competition in the industry. Banks have increased their market share of total assets held by investment dealers from zero percent in 1984 to 70 percent in 1994 and of the trust and loan industry from 36 percent in 1984 to 69 percent in 1994 (Exhibit 5.2). The

There has been no comprehensive evaluation of the regulatory framework.

Banks have significantly increased their presence in the trust and loan industry.

insurance industry is still largely independent; the banks have recently started to increase their presence in that industry. The Superintendent of Financial Institutions, in his recent appearance before the Senate Committee on Banking, Trade and Commerce, stated, "It is my hunch that, although we may reach a point in time where consolidation could decrease competition, we do not seem to be near that point yet." We believe that, while changes in concentration do not necessarily increase or decrease competition, there is a need to evaluate carefully their repercussions on competition over time -- particularly when, since 1967, the government has repeatedly emphasized the objective of promoting competition in the industry.

5.27 There have been several well-publicized failures of financial

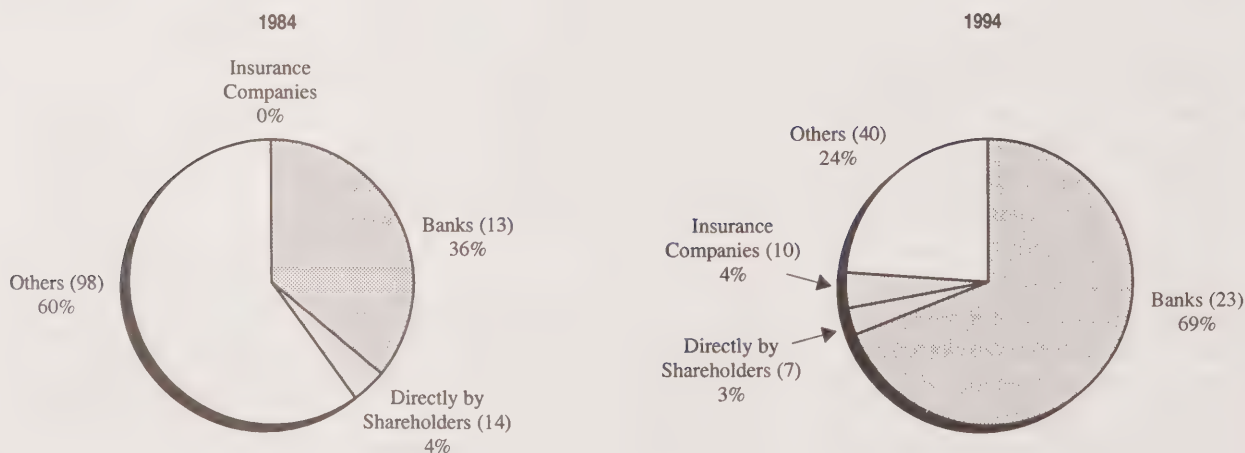
institutions. These events, along with hearings and reports by the Senate Committee on Banking, Trade and Commerce and the House of Commons Standing Committee on Finance, have raised concerns that some important government policy objectives for the financial sector are not being met fully.

5.28 The government should regularly assess the continuing validity of its policy objectives for deposit-taking institutions and carry out comprehensive evaluations of how well the regulatory and deposit insurance system is meeting those objectives.

OSFI's response (5.24 to 5.28): The comprehensive evaluation referred to in this recommendation is earlier defined in your report as "a disciplined assessment of a government program or activity, based on systematic measurement and an

Exhibit 5.2

Ownership of Trust and Loan Companies as a Percentage of Total Assets



Note:

1. Ownership status determined as at 31 December 1994 but asset values used to calculate percentages are as at 31 December 1993 because 1994 figures were not available.
2. Others include credit unions and other Canadian and foreign companies.
3. Numbers in brackets indicate the number of companies.

Source: Office of the Superintendent of Financial Institutions

analysis of its continued relevance, success in achieving objectives, and cost effectiveness compared to alternatives.”

Although we support the principle of building such assessments into all government programs or activities, to carry out such an assessment in this situation would be a complex and difficult undertaking. First, the objectives to be assessed, some of which are referred to in your report, are “soft” ones (e.g. “maintaining and promoting stability in the financial system.”) not easily susceptible to systematic measurement and analysis. Second, such an assessment would have to take into account the impact of the economic shocks with which Canada’s financial system was coping during the recent recession and its aftermath.

The Federal Regulatory System: Structural Weaknesses

5.29 The present regulatory system is affected by structural weaknesses as well as problems in implementation.

OSFI’s mandate not sufficiently clear

5.30 OSFI’s mandate is not set out in one statute. The *OSFI Act* makes the Superintendent responsible for performing duties set out in other legislation on federal financial institutions, such as the *Bank Act*. OSFI’s mandate has to be inferred from such legislation and this makes it difficult for the public to fully understand its role.

5.31 It is clear that OSFI has no statutory mandate to promote broad public policy objectives of stability and competitiveness in the financial system. Its statutory responsibilities are aimed entirely at ensuring that individual institutions comply with their legislation and at reporting on their financial soundness. On its own, OSFI has claimed

in its mission statement that it has the objective of maintaining public confidence in the financial system. Having made the claim, it has not defined what that entails, how it will achieve the objective, and what performance measures it will use to gauge its success. (Exhibit 5.1 identifies some public policy objectives of various players in the regulatory system.)

5.32 By comparison, CDIC has the statutory public policy mandate “to promote and otherwise contribute to the stability and competitiveness of the financial system in Canada”, in addition to providing deposit insurance. The use of the term “promote” would normally envisage a proactive effort by the Corporation. However, the Corporation has not defined what this mandate entails, except to say that the provision of deposit insurance helps to maintain stability and competitiveness in the financial system. As currently worded, though, the mandate is not directly linked to the provision of deposit insurance.

5.33 The current situation presents a dilemma. The primary regulator, OSFI, wants to have the mandate for maintaining public confidence in the financial system, but has no statutory support for it. At the same time, CDIC has the mandate for the stability and competitiveness of the system but has not explained to Parliament how this is discharged. It is possible that legislators did not want the primary regulator to be burdened with public policy objectives; this might have been designed to facilitate and expedite regulatory action by OSFI, particularly when dealing with troubled institutions. It may well be that neither OSFI nor CDIC needs to be encumbered with public policy objectives. An alternative may be to incorporate these objectives into the mandate of the Department of Finance,

It is difficult for the public to fully understand OSFI’s role.

which is responsible for the overall policy direction of the financial services sector.

5.34 The government should clarify the mandates of OSFI, CDIC and the Department of Finance in respect of public policy objectives such as competitiveness in the financial system. Such a review could cover:

- whether OSFI's mandate should be restricted to promoting the well-being of individual deposit-taking institutions, or broadened to include explicit responsibility for promoting competitiveness and stability in the financial system and maintaining public confidence in the system.
- whether CDIC, a deposit insurer, should have a stand-alone, full-scope mandate to promote stability and competitiveness in the financial system, or whether that mandate should apply only in the context of its role of providing deposit insurance and dealing with troubled institutions.
- whether the Department of Finance should be given the exclusive responsibility for the public policy objectives.

(The February 1995 White Paper proposes a mandate for OSFI to be set out in the *OSFI Act*. As to public policy objectives, the preamble to the *OSFI Act* will refer to OSFI's role in contributing to public confidence in the Canadian financial system. The White Paper further proposes to eliminate from CDIC's existing mandate its role in promoting and otherwise contributing to the competitiveness of the financial system.)

OSFI's response: You acknowledge that the Department of Finance Policy Paper proposes a mandate for OSFI and proposes a revision to CDIC's mandate. In our view, the Policy Paper satisfactorily addresses your recommendation. We would not support a

further review of these issues at the present time.

Overlapping statutory responsibilities confuse regulatory roles

5.35 OSFI provides supervised financial institutions with guidelines on prudent risk management and other issues. These guidelines outline OSFI's interpretation of various sections of legislation and what it considers to be prudent practice in particular areas of risk. OSFI currently has about 25 guidelines for banks and for trust and loan companies. The *CDIC Act* requires CDIC to develop and promote standards of sound business and financial practices and it has recently released eight such standards. OSFI's guidelines and CDIC's standards can cover the same subjects, such as capital adequacy and credit risk management, and yet their consequences for the supervised financial institutions can be quite different. For example, non-compliance with standards may trigger a premium surcharge or the termination of deposit insurance by CDIC, with grave consequences for the institution. By comparison, non-compliance with OSFI's guidelines may lead it to direct the institution to comply, or take some similar action, with a quite different impact on the institution.

5.36 This problem can be addressed by giving one organization the role of setting and implementing standards and guidelines or, alternatively, by establishing criteria for selecting subject areas to eliminate overlap between OSFI's guidelines and CDIC's standards. The former course would centralize the regulatory role in one organization. However, this may raise questions of federal-provincial jurisdiction, as OSFI deals with only federal institutions. This issue may need to be examined further as

OSFI's guidelines and CDIC's standards can cover the same subjects.

there may well be alternative ways of handling the problem.

5.37 As another example of significant overlap, an entrepreneur applying to establish a financial institution has to go through two separate processes: one with OSFI in pursuit of its charter and the other with CDIC to obtain deposit insurance. Since a deposit-taking institution otherwise acceptable to OSFI cannot operate without CDIC deposit insurance, there should be ample scope to integrate the two processes by rationalizing statutory provisions. In addition to being more efficient, that could reduce the burden on the applicant. Operationally, both OSFI and CDIC have recently streamlined procedures for the application process, to reduce duplication.

5.38 There are other areas of overlap, such as the monitoring of a financial institution's activities by both organizations. Some overlaps can be desirable. They can provide checks and balances and a healthy tension between the two organizations to produce well-analyzed and considered action plans. However, there is a need for study to identify the overlaps that are constructive and those that are judged to be counterproductive. The latter category could include undue information burden and confusion among financial institutions as well as the possibility that some important regulatory considerations might be overlooked.

5.39 The government should analyze areas of overlap between OSFI and CDIC and take steps to either eliminate overlaps that are judged to be counterproductive or ensure that the two organizations manage them to avoid unnecessary duplication and possible undue burden on financial institutions.

OSFI's response (5.35 to 5.39): We agree that there are areas of overlap between OSFI and CDIC. However, it is important to recognize that these overlaps are largely a product of the different functions of the two organizations and their different jurisdictions. OSFI is a regulator of federal institutions, including banks, trust companies, insurance companies and pension plans. CDIC is an insurer of both federal and provincial deposit-taking institutions. The different responsibilities of these two organizations make some overlap unavoidable. The question then must be, as you point out in your recommendation, whether the two organizations are working to avoid unnecessary duplication and to minimize the resulting burden on financial institutions. A great deal of effort is going into accomplishing this objective. As pointed out elsewhere in your report, the two agencies have developed a document entitled A Guide to Intervention for Federal Financial Institutions that shows how we work together in dealing with federal deposit-taking institutions at various stages of financial deterioration. A number of other mechanisms including a Strategic Alliance Agreement and a Liaison Committee which meets monthly have been developed to encourage co-operation. These initiatives are succeeding and the system of supervision and depositor protection will be stronger as a result. Further study of these issues should not be undertaken until current initiatives have been given an opportunity to show results.

Unclear accountability and lack of transparency in the regulatory system

5.40 We have already noted that the lack of clarity in OSFI's mandate confuses accountability. The problem is accentuated by the fact that there is no clear division of responsibilities between OSFI and CDIC (Exhibit 5.1).

5.41 To discharge their statutory responsibilities, both OSFI and CDIC believe that they are expected to carry out

There is a need to establish clearly whose responsibility it is to detect and gauge the seriousness of problems faced by an institution.

Consideration needs to be given to making available to stakeholders as much information on OSFI's processes as can be prudently justified.

monitoring and risk assessment of the activities of financial institutions, healthy as well as troubled. When problems are not identified early enough, it becomes difficult to ascribe responsibility to either OSFI or CDIC.

5.42 There is a need to establish clearly whose responsibility it is to detect and gauge the seriousness of problems faced by an institution so that appropriate corrective measures can be taken. This should extend to the entire spectrum of the regulator's and the insurer's dealings with an institution. Since both organizations are required to stay involved with the affairs of a troubled institution until a solution is found, it is essential to determine which one has the principal responsibility at each stage of intervention so that it can be held accountable. At present, no such accountability framework exists.

5.43 The Superintendent is accountable to the Minister of Finance, to whom he submits his annual report. OSFI has certain other stakeholders who need information, including financial institutions, depositors and creditors. The annual report and Part III Estimates are the main vehicles for information on OSFI's activities. However, at present they provide only a broad description of activities and little information on performance against objectives. It may well be that, because of management's preoccupation with financial institution crises in recent years, it was unable to devote enough attention to these matters.

5.44 To enhance accountability, there is a need to improve transparency in the regulatory system. Both OSFI and CDIC have a range of regulatory powers that they may exercise. At present, stakeholders do not have concise information on the specific powers or regulatory measures that may be used when an institution infringes upon laws

and regulations or when its financial health deteriorates. The White Paper (see paragraph 5.15) outlines a "Guide to Intervention for Federal Financial Institutions" that would help in achieving greater transparency of the regulatory system.

5.45 Consideration needs to be given to making available to stakeholders as much information on OSFI's processes as can be prudently justified. As an example, OSFI currently uses a risk-rating system called CAMEL (capital, asset quality, management, earnings, liquidity) to assess risk related to individual financial institutions. However, this rating is not communicated to the institutions, although they are given an indication of the problems identified during the statutory examination in a report to management. OSFI needs to consider making the CAMEL rating available to the institutions to enhance transparency. In general, OSFI could determine at the end of each examination the information that might be helpful to the institution. Such information could include best practices in the industry and peer group comparisons, and would be made available to the institution as long as it did not breach confidentiality. This could help the institution to improve its operations and, at the same time, gain greater acceptance of the regulatory process by the financial services industry.

5.46 Relatively little information on failed institutions is available to the public. Some information may be confidential. Also, any litigation or prospect of litigation would have a strong bearing on what could be released publicly. Nevertheless, both OSFI and CDIC need to examine what can be disclosed about the reasons for their actions so that the public can understand the process.

5.47 It is noted that the February 1995 White Paper deals with the subject of enhanced public disclosure of financial data for all institutions. In this regard it seeks to improve the quality and scope of data to be reported in the statutory information returns by financial institutions and the publication of annual financial statements.

5.48 Both OSFI and CDIC, with the support of the Department of Finance, should clarify their accountabilities under their respective legislation, including their relationship with each other. They should outline how they are to discharge these accountabilities. This initiative should be extended to make the regulatory and deposit insurance system as transparent as possible to the stakeholders and the Canadian public.

OSFI's response (5.40 to 5.48): This recommendation has been accepted. The Policy Paper released on February 9, 1995, entitled Enhancing the Safety and Soundness of the Canadian Financial System makes specific recommendations to enhance accountability and transparency in the supervisory process. Annex 2 to the White Paper, the Guide to Intervention, previously referred to, presents a clear statement of what regulatory actions may be taken by OSFI or CDIC, and when those actions are likely to be taken.

Over time, the Guide to Intervention will be improved and further developed. It represents an important step forward in co-ordinating the efforts of OSFI and CDIC and in making the system more transparent to the public. It also indicates how the weight of responsibility and activity shifts as institutions move through various levels of financial difficulty. The Guide to Intervention makes clear that the system is driven by the judgment of two independent agencies working together in close collaboration, but with different mandates and necessarily different perspectives and priorities.

Your report suggests that OSFI should consider making its CAMEL ratings available to each institution. CAMEL ratings are internal ratings based upon criteria developed by OSFI to assess the risk profile of each deposit-taking institution. The ratings require judgments, some of which are highly subjective. Suitable methods to communicate concerns and peer comparisons to the affected institutions currently exist. It would not be useful to communicate specific CAMEL ratings in any format which would risk public disclosure and inappropriate interpretation. The Guide to Intervention outlines some of the criteria used by OSFI to identify the risk profile of an institution and the timing of the communication of OSFI's concerns about the operations of an institution to its board of directors and management.

Role of the Department of Finance is unclear

5.49 In addition to its pivotal role of developing government policy and legislative proposals for the financial services sector, Finance is closely involved with the operations of both OSFI and CDIC. The Deputy Minister of Finance is on CDIC's Board of Directors, where many issues concerning troubled deposit-taking institutions are discussed and, when appropriate, decisions made. The Deputy Minister is also a member of the Financial Institutions Supervisory Committee (FISC), chaired by the Superintendent of Financial Institutions, which discusses the circumstances of troubled institutions and the plans to deal with them. The Department of Finance has formed a Senior Advisory Committee, chaired by its Deputy Minister and including the Superintendent, the Chairman of CDIC and the Governor of the Bank of Canada as its members. This committee provides advice on policy matters. The Department has a direct and regular link with the Minister of Finance,

The legislation governing financial institutions contemplated close co-ordination between OSFI and CDIC.

who has the overall responsibility for the regulatory framework and who ultimately makes many of the critical decisions with respect to failing institutions.

5.50 There is no clear statement of the Department's accountability for the operation of the regulatory framework. In the past, there have been problems with overlap between OSFI and CDIC, co-ordination of their activities and exchange of information. It is not clear what role the Department of Finance plays in such matters, which have persisted for several years. The 1994-95 Part III Estimates of the Department say it is responsible for "the functioning of and regulatory framework for Canadian financial markets and institutions".

However, the Estimates do not identify any specific objectives in this area and how the Department's performance is to be measured. It is noteworthy that the Senate Committee on Banking, Trade and Commerce Report on the Regulatory System, dated 24 November 1994, requested that Department of Finance officials work with OSFI and CDIC to minimize overlap, clarify mandates and assign regulatory responsibilities to OSFI and insurance to CDIC. The Committee has indicated its intention to invite officials to testify on these issues in the spring of 1995.

5.51 The Department of Finance should clearly set out its role in, and its accountability for, the functioning of the regulatory and deposit insurance system, in particular the co-ordination of activities of OSFI and CDIC.

The Federal Regulatory System: Implementation Difficulties

Co-ordinating mechanisms weak

5.52 The legislation governing financial institutions contemplated close co-ordination between OSFI and CDIC to

achieve efficiencies, reduce information overload on member institutions and avoid diffused accountability. Two principal mechanisms for these purposes were to be the Financial Institutions Supervisory Committee (FISC) and the CDIC Board of Directors.

5.53 OSFI and CDIC have signed a "strategic alliance" to facilitate operational co-ordination between them. The alliance deals with a number of important issues. However, it could be further expanded to cover such areas as methodology for the valuation of assets of troubled financial institutions, criteria for placing institutions on the "watch list" and co-ordination of the exercise of statutory powers of the two organizations.

5.54 The execution of the strategic alliance has been a useful approach to achieving better co-ordination between the two organizations. In the past, there have been problems in such areas as the exchange of information and the use of their statutory powers. OSFI and CDIC have recently taken steps to address many of these problems and specific committees have been established to develop approaches and monitor progress. The Superintendent of Financial Institutions and the Chairman of CDIC have undertaken to give their priority attention to improving co-ordination and co-operation between their organizations. We are pleased to observe their commitment and the progress already made, some of which is evident from the recent White Paper. However, their continuing progress needs to be monitored periodically. Also, it would be helpful to formalize as much of the co-ordination process as possible to ensure continuity.

OSFI's comments (5.52 to 5.54): OSFI has a common understanding with your officials that the legislation governing financial institutions contemplated close co-ordination between OSFI and CDIC.

However, as previously noted, your report does not adequately reflect the situation today and the progress made in achieving closer co-ordination between the two agencies. There has been significant improvement over the past two years as evidenced by proposed legislative amendments, improved functioning of the OSFI/CDIC Liaison Committee, and the collaboration and co-operation exhibited in the way OSFI, CDIC and others work together.

*Your report is somewhat misleading in stating that "The Superintendent of Financial Institutions and the Chairman of CDIC have undertaken to give their priority attention to improving co-ordination and co-operation between their organizations", suggesting that this is a future initiative. The Superintendent and the Chairman of CDIC **are already** giving priority attention to this matter in a concrete, formalized way.*

Role of Financial Institutions Supervisory Committee (FISC) unclear

5.55 The mandate and composition of FISC is set out in subsection 18(3) of the *OSFI Act*. The Committee comprises the Superintendent, who also chairs the meetings, the Governor of the Bank of Canada, the Chairman of CDIC and the Deputy Minister of Finance. The statutory mandate of FISC is to facilitate consultations and the exchange of information on all matters relating to the supervision of financial institutions.

5.56 The members of the Committee agreed to comprehensive terms of reference in July 1988, including regular bi-monthly meetings and an opportunity for ad hoc special meetings as required. The Chair was made responsible for the agenda and minutes were to be circulated among members, with copies to the Minister of Finance and Minister of State (Finance). The terms of reference include the exchange of information regarding the

identification of problem areas, strategies for dealing with troubled institutions and the implications for financial institutions of government initiatives or policy proposals. There are indications that not all parties are in accord with the terms of reference.

5.57 For a variety of reasons, FISC has not been making an effective contribution to the process, and has not adequately discharged its mandate; the members of the Committee have acknowledged this. For example, timely information on troubled institutions often has not been available and information on system-wide risks has not always been passed on to all members. Meetings have not always been held at least bi-monthly and minutes of the meetings sometimes have not been circulated for several weeks. OSFI advises that it has recently undertaken initiatives to improve the functioning of FISC.

5.58 While FISC is not a decision-making committee, its minutes indicate that it does have a powerful influence on action taken with troubled institutions. Considering the importance of the role envisaged for FISC in the regulatory framework, there is a need for an independent, in-depth review of its mandate and activities.

5.59 **OSFI should seek a clarification of the mandate of the Financial Institutions Supervisory Committee and conduct a review of its functioning as a mechanism for consultation and exchange of information, with a view to enhancing its effectiveness.**

OSFI's response (5.55 to 5.59): The narrative preceding this recommendation includes a number of statements concerning the operations of FISC. These opinions of particular members of FISC appear to have led to your recommendation. While opinions vary,

While FISC is not a decision-making committee, it does have a powerful influence.

there is agreement among FISC members that the Committee could make a stronger contribution. FISC members have been canvassed for their suggestions on improving the operation of this Committee and steps are now being taken by the Chair of FISC to respond to each of those suggestions.

Operational Challenges and Opportunities

Can OSFI Meet the Challenges of Rapid Evolution?

Need to refocus examination and monitoring priorities

5.60 The pace of change has accelerated, stimulated by the globalization of the financial services industry and the advent of communication and information technology. Moreover, recently permitted cross-ownership of financial institutions and the expanded scope of their activities have resulted in the emergence of financial conglomerates offering, under one umbrella, a full range of financial services.

5.61 Since OSFI places great emphasis on statutory examinations that are done once a year (except for troubled financial institutions, where they may be done more often), there is a danger that the inherent delays will not permit it to stay on top of current developments. By the time an examination report has been completed and discussed with the institution concerned, and the statutory report passed on to CDIC, a fair amount of time has gone by.

5.62 A solution to this problem is effective monitoring: more periodic scrutiny of financial institutions. However, OSFI's monitoring is not rigorous enough and receives only secondary priority. Although OSFI does

not record time spent on monitoring, our interviews with officials and our file reviews indicate that somewhere around 10 percent to 15 percent of examiners' time is devoted to monitoring non-troubled financial institutions; the rest is spent on examinations. Troubled institutions, of course, receive more continuing attention.

5.63 We do not downplay the value of annual examinations. They provide OSFI with an opportunity for a more detailed review of an institution's policies and processes and its governance. They are done on the institution's premises, which permits more direct contact with its officials and management. However, it is difficult for OSFI to cover in depth all potentially high-risk areas, such as treasury, computerized management information systems and estate, trust and agency (ETA) business, every time it carries out an examination. Through enhanced monitoring processes, it might be appropriate to put selected high-risk areas on an examination cycle to undergo in-depth scrutiny once every few years.

5.64 OSFI now monitors non-troubled institutions every quarter. However, several weaknesses in its monitoring process need attention. Except for large institutions, monitoring is normally based on a desk review of information in OSFI's own office, without a visit to the institution. While it might not be necessary to visit the institution every quarter for monitoring, it would be appropriate to meet periodically with senior management to review progress of operations, examine the minutes of the board of directors and selected submissions to it, and review internal audit and inspection reports. OSFI maintains that it conducts such a selective program of regular contact with institutions. However, in our view, OSFI's

Monitoring needs added attention given the dynamic nature of the financial services industry.

documentation requires significant improvement to support that assertion.

5.65 OSFI's principal database and information system for monitoring, the Financial Institutions Reporting System (FIRS), was activated for banks in October 1994. While the existence of such a database and corresponding information system enhances OSFI's examiners' ability to perform adequate trend and ratio analyses, similar capabilities for the trust and loan companies supervised by OSFI are still under development. At this point, FIRS does not contain features permitting forward-looking and sensitivity analyses, both of which are useful to proper risk assessment. OSFI is reviewing the objectives and the scope of a future phase of FIRS development and is considering including these attributes within FIRS itself. It should be noted that OSFI has used a microcomputer-based software in conjunction with FIRS to perform some ad hoc projections of capital adequacy for banks.

5.66 Financial institutions experiencing high rates of asset growth or significant volatility in asset values, sometimes because of aggressive underwriting practices, have not always received enough ongoing monitoring. Similarly, more attention could be given to monitoring an institution's progress or that of its affiliates in the capital and money markets, which are a good barometer of their strengths and weaknesses. In the case of one large institution and its affiliate, the yield spreads on its debt obligations clearly indicated high risk long before the institution was placed on the watch list.

5.67 OSFI completed a monitoring guide for its examiners in September 1993. If monitoring were strengthened adequately, it would support and, indeed,

drive the timing and scope of the examination process. Increased effort at monitoring could reduce the time and resources used in examinations.

5.68 OSFI should give priority to strengthening its monitoring of the activities of financial institutions and should reallocate its resources between its examination and monitoring activities.

OSFI's response (5.60 to 5.68): OSFI recognizes the need to continually assess the risks facing financial institutions to ensure that the supervisory process, which we view as a seamless process of monitoring, planning, on-site examination and reporting, continues to focus on the key risks. While the majority of time is spent on monitoring and on-site examinations, the separation of these activities is often difficult because of ongoing contact with the financial institution. OSFI continues to review its examination methodology to ensure a proper balance between monitoring and on-site examination, taking into consideration the risk profile of the institution and the scope of its activities.

While OSFI maintains regular contact with the institution as part of its ongoing monitoring, we acknowledge that our documentation of monitoring procedures and the results of monitoring needs improvement. This area will receive closer attention in the future.

The introduction of the FIRS data base and other advances in technology will permit closer monitoring of the operating performance of financial institutions and is expected to result in more timely identification of key trends.

Keeping pace with fast-moving developments requires greater emphasis on corporate governance

5.69 Corporate governance of financial institutions carries with it particular fiduciary responsibilities. The

The board of directors and senior management are better placed than regulators to assess and manage risks.

1992 legislation addressed the risks of self-dealing, conflicts of interest and unlawful use of insider information by introducing expanded duties for audit committees, increased liabilities for directors (personally liable in some situations), and the concept of conduct review committees, comprising outside directors only, to oversee related party activities of financial institutions. The new legislation seeks to address the weaknesses that existed prior to its enactment as well as to strengthen corporate governance in respect of the expanded business powers that it provided to institutions.

5.70 Financial institutions may take major financial risks in areas such as underwriting of securities, financial derivatives and high-value transactions. The board and senior management are better placed than regulators to assess and manage these risks. This places more responsibility on them for corporate governance and for informing OSFI of adverse events and trends affecting the institution's well-being. OSFI should clarify its expectations of the board and management.

5.71 Management weaknesses have often been cited as a principal cause of financial institution failure. The standards for sound business and financial practices issued by CDIC provide some guidance, in that each standard contains a separate section on the roles of management and of the board of directors. However, the scope is restricted to the subject of the standard, such as management of interest rate risk.

5.72 OSFI has not issued a guideline to financial institutions on corporate governance. In view of the increasing complexity, scale and scope of financial institutions, several of which are conglomerates or units of them, OSFI

needs to consider making clear what it expects of the institution's board, senior management and internal auditors. Moreover, it needs to define its role in scrutinizing the appointments to the board and senior management as well as in monitoring reasons for departures of board members or senior managers. Other areas to consider are the compensation practices of senior management, which have been a cause of concern with some troubled institutions in the past, and intercompany management fees.

5.73 OSFI is currently conducting a system-wide study of corporate governance as it relates to the expanded powers granted to banks in 1992 and the management of their subsidiaries.

5.74 OSFI should make clear what it expects of the board of directors, senior management and internal auditors in the governance of a financial institution in order to be able to monitor performance in relation to those expectations.

OSFI's response (5.69 to 5.74): OSFI has taken a very active role in outlining its views on corporate governance in a number of ways: OSFI executives have spoken frequently in public on the importance of corporate governance; OSFI meets with the Audit Committee of the board and separately with the independent directors after each examination of a financial institution; a copy of the examination report is sent to the Chairman of the Audit Committee; and, where appropriate, institution-specific weaknesses are discussed privately with directors. In the course of such meetings and reports, OSFI routinely highlights perceived deficiencies and other issues relating to the governance of the institution.

It should be noted that federal legislation prescribes duties for boards and directors. Although OSFI has not issued a guideline on corporate governance outlining our

expectations of boards and management, several agencies and professional groups, such as the Toronto Stock Exchange, the CDIC, the Canadian Institute of Chartered Accountants and the Canadian Comprehensive Auditing Foundation, as well as individual accounting firms, have issued guidance on corporate governance focussing on the responsibilities of directors and management. We do not believe it is either necessary or cost-effective for OSFI to duplicate these efforts by producing a similar document; however, OSFI is committed to maintaining constructive dialogue with directors and management on this key issue.

System-wide studies of emerging risks need further strengthening

5.75 In recent years OSFI has conducted system-wide studies in such areas as large loan exposure of institutions, real estate exposure and internal audit coverage of Schedule I bank activities in financial derivatives. As mentioned earlier, OSFI is currently conducting a system-wide study of certain aspects of corporate governance. There are several other system-wide risk areas that could usefully be studied. These include financial conglomerate and concentration risks, jurisdictional and regulatory gaps, off balance-sheet and over-the-counter financial instruments, securities activities, and estate, trust and agency (ETA) exposure. OSFI advises that a proposal to conduct a system-wide study of derivatives activity is currently under development.

5.76 Because an in-depth understanding of industry trends and developments that might affect the well-being of financial institutions is so important, OSFI needs to upgrade its efforts at conducting system-wide risk studies. Moreover, any studies in the field should be done when a problem is

anticipated rather than when it has already become serious. This has not always been the case. Among the four players in the regulatory framework, OSFI needs to have the principal responsibility for system-wide studies in proper co-ordination with the other players, who also have an important interest in the area.

5.77 OSFI should review its approach to conducting system-wide risk studies to ensure that all necessary studies for proper risk assessment and risk management are carried out, as far as possible, when a problem is anticipated and before it reaches serious proportions.

(The White Paper proposes to include in the mandate of OSFI an object “to consider system-wide or sectoral issues which may have a negative impact on the financial condition of financial institutions.”)

OSFI’s response (5.75 to 5.77): As confirmed in your report, OSFI has conducted system-wide studies of emerging risks where, in our opinion, the risk warranted a cross-system review. OSFI will continue to monitor industry trends and will, where warranted and cost-effective, carry out system-wide reviews.

OSFI does not agree that some of the risks identified in your report, such as conglomerate risk and Estates Trusts and Agencies (ETA) business represent system-wide risks. There are risks associated with some conglomerate structures and ETA business but these risks tend to be entity or institution specific. OSFI will also continue to ensure that our examination and monitoring practices are designed to identify significant risks before they become system-wide problems. OSFI will continue to expand its examination procedures in selective areas, when in its opinion, the risk profile warrants the additional work.

An in-depth understanding of industry trends and developments that might affect the well-being of financial institutions is important.

Growing importance of co-ordination with other regulators in Canada and abroad

5.78 Major banks in Canada all have significant and growing foreign operations, including securities and derivative activities as well as traditional banking. Similarly, many foreign banks have established Schedule II bank subsidiaries in Canada. With the growing importance of cross-border capital flows and the prospect of major events and disturbances in international markets being transmitted quickly to domestic markets, a close liaison with foreign regulators is needed for exchange of information. OSFI advised us that it has regular communications with foreign regulators, both through its participation in the Bank for International Settlements and on an informal basis. While it is acknowledged that there may be legal or other restrictions in some jurisdictions to prevent release of reports to OSFI, reports should be obtained to the maximum extent possible.

5.79 OSFI faces major challenges in co-ordinating its activities with provincial regulators. Aside from accords for the exchange of information on securities subsidiaries of federally regulated institutions, there are no formal arrangements for federal-provincial co-operation where both jurisdictions are involved in regulatory activities. There is a need to determine if sufficient effort is being made to minimize duplication, through harmonizing federal and provincial regulatory systems and formalizing arrangements for exchange of information and other operational matters. We are advised that, at the federal level, Finance is responsible for the harmonization of federal and provincial regulatory systems, including operational matters.

OSFI faces major challenges in co-ordinating its activities with provincial regulators.

The regulatory system cannot always prevent failures but its processes can detect unsound business practices.

OSFI's comments (5.78 to 5.79): Where possible, and in accordance with regulatory agreements, OSFI does obtain copies of other regulatory reports and co-ordinates its activities with other regulators. For example, Memoranda of Understanding exist between OSFI and the provincial securities commissions for the exchange of information on securities subsidiaries of federally regulated institutions and regular contact is maintained with Ontario where possible regulatory overlap may occur because of Ontario's "equals approach", and with provincial securities commissions on issues of common concern.

OSFI Supervisory Processes Have Improved but Further Significant Work Needs to Be Done

5.80 As noted in paragraph 5.19, OSFI has achieved greater systematization of its examination and monitoring processes. However, the following areas need OSFI's further attention.

Processes for handling troubled institutions need strengthening

5.81 The recent recession in Canada, coupled with the serious decline in the value of commercial real estate in central Canada, caused considerable stress on the financial services industry and several financial institutions failed. The regulatory system cannot always prevent failures but its processes, properly structured and maintained, can detect unsound business practices that could lead to failures and consequent demands on CDIC's resources. It needs to be recognized that, when considering the role of the regulator in handling troubled institutions that failed, one must also look at instances where the regulator was able to assist in an institution's restructuring and survival. We have observed situations where OSFI's intervention led to positive results; either the troubled institution

involved recovered its financial health or the institution's financial condition was stabilized and further deterioration avoided.

5.82 OSFI has a wide array of powers to deal with emerging problems in a deposit-taking institution before it would report to CDIC that the institution was no longer "viable" or ask the Minister to seek a "winding up" order. OSFI may begin by using moral suasion or obtaining letters of undertaking from an institution's board of directors. More serious action would be to issue a direction to comply and receiving instructions from the Minister of Finance to take control of the company.

5.83 It is evident that OSFI has ample discretionary powers, short of closing down an institution before it becomes technically insolvent, to deal with emerging problems in financial institutions. The more difficult questions facing OSFI entail the use of these discretionary powers. First, there is the question of timely identification of the seriousness of problems faced by institutions. Then there are the questions of which discretionary powers to use and how quickly to use them.

5.84 Our examination of troubled institutions showed that, in several cases, companies could have been put on the "watch list" sooner. Also, comprehensive action plans to deal with the institution's problems were seldom prepared when it was placed on the watch list. Earlier identification of problems and a more timely placing of institutions on the watch list might facilitate constructive consultation among the various players in the regulatory framework, notably OSFI, CDIC and Bank of Canada. Using their respective powers, they could then take concerted corrective action.

5.85 In its recently released White Paper (see paragraph 5.15), the government outlined a "Guide to Intervention for Federal Financial Institutions". The Guide describes broad circumstances that might lead to certain intervention measures of OSFI and CDIC. It also outlines interagency activities/responsibilities for such measures. The objective of the document is to promote awareness and to enhance transparency of the system among financial institutions and other interested parties. Its implementation is not conditional on legislative changes proposed in the White Paper.

5.86 The Guide represents a step in the right direction to enhance transparency. However, for it to become a useful instrument in directing internal operations of OSFI and CDIC, it needs to be put into practice. For instance, the Guide outlines the powers of the two organizations but does not say whose powers are to be used under what circumstances. The risk factors outlined, such as poor earnings and undue exposure to off balance-sheet risk, need to be defined and the definitions accepted by both OSFI and CDIC to be effective. Within OSFI, there is a need to establish a framework outlining ground rules to the examination staff for triggering the early-warning mechanism and for proposing discretionary intervention measures. These would then form the basis for senior management to make decisions on the matter. Without systematic guidance, OSFI is exposed to potential criticism that it might not have used its discretionary intervention powers on a timely basis to seek a resolution to an institution's problems.

5.87 The systems and practices of the Compliance Division, which is responsible for handling acutely troubled

The "Guide to Intervention for Federal Financial Institutions" represents a step in the right direction to enhance transparency.

institutions, have never been reviewed by internal audit or any other independent party to assess their effectiveness. However, an internal quality control review, involving the statutory examination of one troubled institution, was carried out in 1994.

5.88 OSFI should review and formalize the processes used to support the exercise of its discretionary powers and to develop comprehensive action plans to deal with troubled institutions so that remedial measures are taken promptly.

OSFI's response (5.81 to 5.88): The paragraphs leading up to this recommendation indicate that the Guide to Intervention for Federal Financial Institutions, prepared jointly by OSFI and CDIC, would respond to this recommendation if implemented. Despite our assertions to the contrary, your officials seem unwilling to accept that, in most respects, the Guide to Intervention describes procedures which have been in place for some time. The exceptions are few in number and are those procedures which cannot be implemented until the Department of Finance Policy Paper recommendations are enacted through legislation.

Your report also criticizes the Guide to Intervention for lack of precision as to which powers of which organization will be used under which circumstances, and for lack of specificity as to the risk factors and trigger mechanisms which will cause OSFI and CDIC to initiate particular actions. We have a clear difference of view on these points. Your officials appear to favour a more mechanical system in which specific regulatory intervention would be required when specific numeric thresholds were violated. We have such thresholds and these were discussed with your officials. However, these are used as guide posts rather than mandatory triggers. In our view, it is

essential to preserve the role of judgment in determining when and how to intervene. There are too many intangible factors, such as the quality of management, which must be factored into any intervention decision.

Although we would resist attempts to make the Guide to Intervention a more mechanical document, with less scope for the exercise of regulatory discretion, we will be monitoring the effectiveness of the approach set out in the Guide to Intervention, and will be improving and expanding it as needed.

More assessment of specialized risk areas is needed

5.89 By far the largest proportion of OSFI's examination resources is devoted to assessing credit risk in financial institutions. OSFI engages credit consultants, who are retired senior bankers, to examine the adequacy of loan loss provisions and loan documentation in institutions. The consultants bring a valuable business background to the examination process. Credit consultants do not conduct on-site inspections of assets-securing loans. Examination work is based entirely on information contained in the files of the financial institution. We noted that OSFI has, on occasion, required independent appraisals to establish the value of real-estate assets securing loans.

5.90 Other specialized areas that could have a major impact on the safety and soundness of a financial institution include treasury (including derivatives), computerized management information systems, estate, trust and agency (ETA) business and securities operations. OSFI has not established procedures to examine a financial institution's systems and practices for managing risks in these areas.

5.91 To date, specialists other than credit consultants have been used by OSFI

Specialists other than credit consultants have been used by OSFI in only a few cases.

in only a few cases in the examination process, because in OSFI's judgment the potential risks involved did not warrant the use of such specialists. Our audit identified several cases where such specialists might have played a constructive role in assessing risks. These cases included financial institutions that were heavily involved in derivative products as market makers or as end users, or that were in the process of entering into

these activities in a significant way. The growing importance of derivative products can be seen in Exhibit 5.3, which demonstrates that the credit equivalent amount (a measure of current and potential future credit risk exposure) of outstanding interest rate and forward exchange rate contracts of Canada's six largest banks increased by 157 percent from 1989 to 1994. For computerized management information systems, OSFI

**Derivatives exposure
of Canada's major
domestic banks
increased
substantially.**

Exhibit 5.3

Off Balance-Sheet Exposures in
Derivatives of Canada's Six Largest Banks
Year Ended 31 October
(in billions of dollars)

	Notional Principal (1)			Credit Equivalent (2)		
	1989	1994	% Change	1989	1994	% Change
Interest Rate Contracts:						
Interest rate swaps	183	840		4	14	
Forward rate agreements	77	484		0	1	
Interest rate options (purchased)	6	101		0	1	
Others	6	2		0	0	
Sub-total	272	1,427	425	4	16	300
Forward Exchange Rate Contracts:						
Forward foreign exchange contracts	561	1,119		17	31	
Cross-currency swaps	8	42		0	4	
Cross-currency interest rate swaps	33	67		2	6	
Currency options purchased	9	47		0	1	
Others	0	7		0	1	
Sub-total	611	1,282	110	19	43	126
TOTAL	883	2,709	207	23	59	157

- (1) The notional principal, or face value, of a derivative is typically not the amount at risk because there is no exchange of notional principal.
- (2) Credit equivalent is used by financial institutions to estimate the amount of their derivatives exposure. Credit equivalent has two components: replacement cost and potential future credit exposure. Replacement cost is the cost of replacing the remaining cash flows of a contract if the counterparty to the contract defaults. Potential future credit exposure represents the impact on replacement cost of adverse movements in the underlying variables determining the value of the contract.

Credit equivalent does not take into account other risks such as liquidity risk, legal risk, operations and systems risk.

Source: Office of the Superintendent Institutions (Capital Adequacy Returns)

tends to rely on the work done by internal and external auditors but the basis for such reliance is often not supported.

5.92 In some trust companies, fees derived from ETA business account for a major proportion of their income. There are risks inherent in ETA activity, particularly with respect to assets under investment management. They include risks associated with securities lending, commingling of assets and safekeeping. OSFI has not defined these risks, nor has it set out procedures to examine and monitor them. In one institution we examined, ETA assets under management amounted to three times the book value of its total assets. OSFI's examination procedures were not well targeted to assess related risks and to provide reasonable assurance that the institution's practices respecting ETA business were sound. Although ETA activities fall under provincial jurisdiction, OSFI needs to find ways and means of assessing risk in an institution where such activities constitute a major proportion of its business.

5.93 Several banks engage in securities activities in their own name as well as through securities subsidiaries. The securities subsidiaries are regulated provincially and OSFI has memoranda of understanding with several securities commissions for exchange of information. However, in recent years there has been an increasing level of operational integration between banks and their securities subsidiaries in such areas as back office operations. This raises the question of regulatory gaps that might have emerged through integration. Similarly, there is a need to examine whether the memoranda of understanding provide an effective mechanism for the timely exchange of information on examinations and monitoring of securities activities. As it now stands, the securities commissions are under no obligation to provide timely

warning to OSFI of emerging problems in an institution.

5.94 Section 6(2) of the *OSFI Act* requires the Superintendent to examine and inquire into securities activities of financial institutions, such as underwriting and trading in securities, and to report to the Minister from time to time on all related matters. So far, OSFI has carried out only a limited review of securities activities and has not reported on it to the Minister. There is no methodology in place for the examination of securities activities. On a broader matter, OSFI has not implemented any procedures for ensuring its own compliance with the various provisions of the *OSFI Act* and the legislation it administers.

5.95 **OSFI should strengthen its processes for assessing risks associated with such areas of specialized risk as treasury, computerized management information systems, estate, trust and agency (ETA) business, and securities activities. OSFI should comply with the requirements of the *OSFI Act* in respect of securities activities and provide periodic reports on them to the Minister.**

OSFI's response (5.89 to 5.95): OSFI continues to monitor industry and institution-specific trends. Where, in our opinion, outside consultants would add value to the examination, these resources are obtained. In each of the cases identified by your officials, our assessment of the risk profile of the institution caused us to conclude that the use of outside consultants was not warranted.

ETA activities are subject to provincial jurisdiction and to date have not been considered high risk to the safety and soundness of the institutions involved. However, for those institutions where there is a significant level of ETA business, our staff review the risk management practices the institution has in place with

management and the internal audit or inspection division. We also acknowledge that this area is growing in importance due to changing demographics and the entrance of the banks into the trust business; as a result, we are currently reviewing this area of activity, identifying the related risks and assessing whether further regulatory scrutiny is required.

OSFI is also well aware of the increasing level of operational integration between banks and their securities subsidiaries, and has discussed this development with the institutions concerned. In addition, we have had preliminary discussions with securities regulators on forming a working group to assess the regulatory implications.

The Superintendent reports annually to the Minister under section 533(1) of the Bank Act on the results of the examinations and inquiries into the business and affairs of each bank. The Superintendent reports on the financial condition of the consolidated bank, which includes the results of its subsidiaries. To the extent that the Bank Act permits securities activities to be conducted by the bank itself, those activities are reviewed by OSFI as part of its examination of a bank's overall asset-liability, corporate treasury and risk management processes.

As a result of banks being given the power to enter the securities business in 1987, section 6.2 of the OSFI Act gives the Superintendent legislative authority to obtain information on the securities activities of the bank even when they are conducted through a provincially regulated subsidiary. Recognizing that this section might raise federal/provincial jurisdictional issues, the Memoranda of Understanding (MOUs) were proposed and signed to minimize these concerns. However, if one of the provinces or OSFI should choose to cancel its MOU, which either can do with 180 days notice, this section of the OSFI Act ensures that the Superintendent would still have the

authority "to examine and inquire into the carrying out of these activities." The MOUs continue to operate satisfactorily; as a result, we have determined that no reporting has been required under this section.

Need for enhancement of skills, training and experience

5.96 OSFI devotes about one percent of its salary budget to training and development. Given the complexity of financial institution operations and the changes taking place in the financial services industry, the skills and information base of examination staff need to be updated and improved periodically. This need was more obvious in the specialized risk areas of treasury, computer systems, ETA business and securities operations. We recognize that training its examiners to become expert in these areas would be a major commitment by OSFI, and possibly not cost-effective. However, the examination staff should have sufficient training to identify risks and to monitor the work of specialists when they are engaged. In our view, training for the examination staff may need to be further strengthened. We are advised that OSFI has now decided to increase its resource commitment to training.

5.97 In the past, OSFI has used an interchange program to augment its own resources with people from the private sector. This program has been quite helpful in bringing fresh approaches to OSFI's operations; it could be expanded. At the same time, OSFI could consider sending its own people outside to broaden their experience and enhance their training.

5.98 We also note that there is little movement of staff between OSFI's deposit-taking institutions sector and its insurance and pensions sector. Even

OSFI has decided to increase its resource commitment to training.

within a sector, there is little movement. For example, in the deposit-taking institutions sector, there is no mobility or interchange of staff between the Examination and the Compliance divisions (located in different cities), although there are many similarities in their functions. This is quite unlike the banking industry, where staff often move between the credit department and the unit responsible for working out delinquent loans. We are advised that the staff of the two divisions work together in conducting examinations of troubled institutions. A properly structured program of staff interchange could provide not only efficiency gains but also opportunities for training and development.

5.99 OSFI should enhance its processes for training and development of its staff and for the cross-fertilization of their expertise and experience.

OSFI's response (5.96 to 5.99): OSFI has acknowledged the need for examination staff to be updated on a regular basis given the complexity of financial institution operations and the changes taking place in the financial services industry. Market factors have made enhanced training programmes difficult to implement; however, the amount of monies set aside for industry specific and new product awareness programmes to be provided to OSFI staff for the 1995–1996 fiscal year have been increased over the previous year.

Methodology development receives insufficient priority

5.100 We expected OSFI to have in place an effective methodology development function to develop, review, and enhance examination and monitoring procedures.

5.101 It was not until 1992 that OSFI established a methodology group in its

organization. Before that, in late 1989, OSFI had issued an examination framework. That document has been useful in guiding on-site examinations of institutions. The methodology group has developed a dozen examination guides on different subjects since its inception; the first guide was implemented in 1993. Another nine guides are at different stages of development. A guide sets out procedures, including minimum procedures, to be followed by examiners at various stages of examination and monitoring.

5.102 Although the methodology development function is vitally important to meet OSFI's mandate, it has not received the attention it deserves. The function has been essentially dormant since the departure of its director in early 1994. We observed that delays in the completion of examination guides have slowed down staff training in some important areas.

5.103 OSFI should place greater emphasis on methodology development to enhance examiners' capabilities in risk assessment and risk management.

OSFI's response (5.100 to 5.103): We support the need for a strong methodology development function that is dedicated to developing and enhancing the examination and monitoring procedures. Efforts have been under way for several months, so far unsuccessful, to fill the complement of the methodology division.

Enhancement through quality control and lessons learned from past experience

5.104 Post mortems rarely done. OSFI has no policy for conducting post mortems. Of seven federally regulated deposit-taking institutions that have failed and about eight that have been the subjects of distress sales since 1987, it has done a post mortem on only four, and

OSFI has no policy for conducting post mortems.

three of those were at the Minister's request. Those post mortems did not sufficiently assess whether the regulatory measures OSFI took were timely and adequate. The post mortems were prepared by OSFI units directly involved in the scrutiny of the failed institutions' problems, without review by a more independent party. In some cases, the results of the post mortems were not communicated to examination staff to guide their work in future.

5.105 Insufficient post-examination quality control reviews. OSFI recognizes the contribution that post-examination quality control reviews can make to ensuring that its processes are consistent and cover their full intended scope. To this end, in 1994 it carried out two quality control reviews of the Examination Division and the Compliance Division. However, these were the only reviews since 1990 and their scope was limited. Furthermore, one of the reviews was done by persons not fully detached from the functional area reviewed.

5.106 OSFI should carry out post mortem analyses of financial institutions that failed or were the subjects of distress sales, and use the lessons learned to enhance regulatory practices. It should also implement systematic and independent post-examination quality control reviews to provide sufficient assurance of compliance with examination standards.

OSFI's response (5.104 to 5.106): Three of the four post mortems to which the Auditor General refers were performed after the failure of relatively large financial institutions. We accept the recommendation that there be a formal process for the conduct of a post mortem where an institution fails. Where an institution is acquired by a stronger

participant, without benefit of subvention from CDIC, then it is not proposed that a formal post mortem be conducted. The entire supervisory process, including monitoring and examination, continually provides OSFI with opportunities to improve its regulatory practices, as will formal post mortem of failures.

As acknowledged by the Auditor General, since 1987, monitoring and dealing with the problems of financial institutions under stress has taken a great deal of OSFI's time and effort. In the same period, We developed a framework for risk assessment and risk management and the necessary human resource infrastructure to carry out our statutory mandate. In addition, in 1992, in response to changes in the legislation and to reinforce the application of a consistent examination methodology, the activities of three separate examination units were integrated. As a result, OSFI's resources have been taxed and full implementation of systematic and independent post-examination quality control reviews has been delayed. However, we recognize the need for post-examination quality control reviews and the contribution they can make in improving the examination process. It was for this reason the reviews referred to in the chapter were carried out. Efforts will be made to have quality control reviews carried out on an annual basis in future.

OSFI recognizes the contribution that post-examination quality control reviews can make.

Operational Efficiency Continues to Be a Challenge for OSFI

5.107 Deposit-taking institutions pay the cost of OSFI's and CDIC's operations. The operating and intervention costs of the deposit-taking institutions sectors of OSFI and of CDIC from 1987 to 1993 amounted to about \$107 million and \$124 million respectively. In addition, CDIC spent \$2.2 billion in that period to meet the losses from federally and provincially regulated institutions that failed or were the subjects of

There is a need to
review OSFI's
organizational
structure.

CDIC-assisted sales. This brings the operating and other costs of OSFI and CDIC to a total of about \$2.4 billion. As can be seen, OSFI's operating and intervention costs represent only a fraction (about five percent) of the total costs. Since the two organizations' mandates and scope of activities are so closely intertwined and they deal with substantially the same clientele, it is appropriate to look at their combined costs. For example, strengthening OSFI's processes, which would entail additional costs, could ultimately reduce CDIC's costs significantly: some deposit insurance losses could be eliminated through faster regulatory interventions and fewer failures of institutions.

5.108 Opportunities for cost efficiencies. We have identified throughout the chapter several opportunities for achieving cost efficiencies. These include better co-ordination and sharing of information between OSFI and CDIC and between OSFI and other regulators. OSFI's and CDIC's methodologies for asset valuations could be harmonized and their monitoring of non-troubled financial institutions could be integrated. Several of these opportunities, if realized, would not only result in cost savings but also reduce information burden on financial institutions, which they claim is substantial at present.

5.109 There are several other opportunities for cost efficiencies:

- Both OSFI and CDIC are carrying out separate projects to develop comprehensive databases and related information systems. They could examine the possibility of combining their efforts in this area, as their needs are quite similar. OSFI could also examine whether its present Financial Analysis Unit will be needed once its database and information systems are in place.
- At present, OSFI has separate examination and monitoring units for deposit-taking institutions, insurance companies and pension plans. In view of the broadening of the scope of activities of different types of institutions, and their cross-ownership, there is an argument in favour of integrating the examination and monitoring activities into one unit and the related administration and support activities into another. This may not only produce a well-integrated and effective examination and monitoring system, responsive to changes in the industry, but also yield certain cost efficiencies. The deposit-taking institutions sector and the insurance sector have separate policy research and analysis activities. In addition, there is the Policy Support Division, which has a rather general mandate. These activities could be integrated to provide for further efficiencies. All of this points to the need for a review of OSFI's organizational structure.
- The Canadian regulatory system is based largely on self-regulation and self-governance by financial institutions. OSFI needs to make it as clear as possible what it expects of financial institutions. For example, OSFI has developed an internal checklist for institutions' compliance with legislation. The checklist could be released to the institutions so that they could monitor and report on their own compliance to meet OSFI's requirements. Additional work performed by financial institutions on behalf of OSFI could reduce examination time and cost.
- OSFI will have to deal with emergencies in financial institutions from time to time. It needs a sufficiently mobile work force with suitable skills so it can marshal resources to handle the emergencies. For example, if new, damaging information about an institution came to light and a major investigative

effort had to be mounted, having mobile resources would be helpful and cost-effective. OSFI needs a crisis management strategy, which it does not have.

5.110 The government should encourage OSFI and CDIC to explore all avenues of achieving cost efficiencies to reduce financial demands on the industry. OSFI should review its operations with a view to enhancing its efficiency. Such a review should cover: consolidation of OSFI's examination, monitoring and support functions between deposit-taking institutions and insurance sectors; encouragement of further self-assessment and self-compliance by financial institutions

to reduce supervisory costs; and the organizational structure of OSFI.

OSFI's response (5.107 to 5.110): This recommendation has merit and will receive active consideration. Consultations which the Superintendent has been carrying out within OSFI and with the institutions that we supervise have confirmed the need for more operational integration. OSFI continues to face major challenges in recruiting and retaining examination staff in Toronto due to current employment market conditions. This will further stimulate our efforts to reassess the way we carry out our work, how and when external consultants are to be used, while at the same time ensuring a cost-effective system of regulation.

Audit Team

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For further information, please contact Beant Barewal, the responsible auditor.



April 20, 1995

Mr. Denis Desautels, FCA
The Auditor General of Canada
240 Sparks Street
Ottawa, Ontario
K1A 0G6

Dear Mr. Desautels:

I am writing to thank you for the draft report, dated April 12, 1995, prepared by your Office on the Deposit-taking Institutions Sector of the Office of the Superintendent of Financial Institutions, following a value-for-money audit of that Sector.

A good deal of useful work was performed in the course of your audit, and my colleagues and I concur with many of your recommendations. There are, however, several observations and recommendations which we believe require further comment.

For ease of reference, our comments generally follow the specific recommendations to which they relate.* However, by way of overview, we would make four broad observations.

First, many of your recommendations have now been addressed through actions already taken and in two documents: a Policy Paper entitled *Enhancing the Safety and Soundness of the Canadian Financial System*, recently issued by the Department of Finance, and an Annex to that document entitled *Guide to Intervention for Federal Financial Institutions*, prepared jointly by the Office of the Superintendent of Financial Institutions (OSFI) and the Canada Deposit Insurance Corporation (CDIC). Reference is made in your report to the two documents but, in my view, the report understates the extent to which issues raised are addressed in these documents. In addition, the report often ignores remedial actions already taken.

Second, your report places heavy emphasis on the need for a comprehensive evaluation of the effectiveness of the system for regulating federal financial institutions. It also recommends that an accountability framework be established to document the precise responsibilities of the various federal government agencies participating in the regulatory system, including OSFI, CDIC, the Department of Finance and the Bank of Canada. These are both laudable goals, and given your responsibilities, you probably cannot do other than put them forward. However, as I will explain in more detail, both may prove to be time consuming to achieve, and the results could be elusive. I also have serious concerns about the cost-benefit relationship of such efforts, particularly given work that has already been done to address these issues.

Third, somewhat to my surprise, there are still a few disagreements between my colleagues and yours as to basic facts. Notwithstanding many useful and constructive discussions with your officials, in some instances, they have been unwilling to accept our assertions as to procedures we use, and have sought more detailed documentation of those procedures. We do accept your need to see satisfactory documentation, but in some cases the level of detail you appear to require is unrealistic.

Fourth, there is an overriding issue of materiality and perspective that concerns us. Several of the recommendations in your report are well-intentioned and may be conceptually valid, but deal with issues that we would not consider to be material in the overall context of OSFI's responsibilities. With many challenges facing us in OSFI, we need to set priorities in order to focus on the issues that are most important.

With these background comments, let me now turn to some of your specific recommendations.*

*Editor's note: detailed comments on specific recommendations are incorporated in the body of the report.



I again thank you for the efforts that you and your colleagues have made to understand our activities and provide constructive suggestions. To the extent that resources permit, we will be proceeding to implement many of your recommendations.

Your very truly,

John Palmer
Superintendent

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Report of the
Auditor General
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to the House of Commons

- Chapter 6**
Federal Transportation Subsidies
- The *Western Grain Transportation Act* Program
 - The Atlantic Region Freight Assistance Program

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 6

Federal Transportation Subsidies

- The *Western Grain Transportation Act* Program
- The Atlantic Region Freight Assistance Program



May 1995

This May 1995 Report comprises 8 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 6

Federal Transportation Subsidies

*The Western Grain
Transportation Act Program*

*The Atlantic Region Freight
Assistance Program*

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: *Shahid Minto*
Responsible Auditor: *Hugh A. McRoberts*

Federal Transportation Subsidies

The Western Grain Transportation Act Program

The Atlantic Region Freight Assistance Program

Main Points

6.1 On 27 February 1995, near the end of our audit of the *Western Grain Transportation Act* Program and the Atlantic Region Freight Assistance Program, the government announced the termination of both programs effective 1 August and 1 July respectively. Notwithstanding, we decided to proceed with the presentation of certain of our observations for several reasons: some will assist Parliament in its deliberations on these programs, some will assist in accountability, and some point to matters that will need attention in the wind-up or transition phases of these programs.

6.2 In presenting our findings on these two programs in a single volume, there is a risk that the reader might be led to make comparisons between the two programs. However, each program is unique, with different acts and objectives, and they presented their respective managements with very different sets of challenges. In some circumstances, what was easy for one was difficult for the other due to the wide differences in the design and history of the programs.

The Western Grain Transportation Act Program

6.3 The *Western Grain Transportation Act* (WGTA) was passed in 1983 to facilitate the transportation and handling of Western grain. We examined the roles of the Grain Transportation Agency (GTA) and the National Transportation Agency (NTA) in the program.

6.4 The Grain Transportation Agency has responded to the recommendations that we made in 1987 with respect to the preparation of the grain forecast. However, it has not fulfilled the requirements in the Act for monitoring the performance of the railways and others involved in the grain transportation and handling system.

6.5 Because the rate for grain transportation by rail will continue to be regulated during the transition period for the program (until 2000), the issues of grain hopper car allocation, demand peaking, and the efficient use of the grain hopper car fleet will continue to need attention. We discuss these issues briefly and make recommendations to the Department of Transport, which will be responsible for managing these matters when the Grain Transportation Agency is abolished.

6.6 We observed that the National Transportation Agency had appropriate controls in place for the *Western Grain Transportation Act* payments to the railways.

6.7 The Act requires the National Transportation Agency to conduct an annual review of railway investment plans and a quadrennial review of the railways' costs for grain transportation. Both reviews require the Agency, among other things, to assess investments and costs with respect to their contribution to "an adequate, reliable and efficient" rail transportation system for Western grain. In both cases, the Agency has informed us that it carried out the required assessment on a qualitative basis; in both cases, the documentation of this aspect of the Agency's work did not allow us to determine whether or not the Agency's conclusions were correct.

6.8 At the end of the transition period, the government has mandated that two program reviews will be done: one by industry in 1998, and the other by the government in 1999. The Department of Transport and the National Transportation Agency must begin planning and gathering data now to ensure that the necessary information to carry out these reviews will be available.

Main Points (cont'd)

The Atlantic Region Freight Assistance Program

6.9 The Department of Transport has prepared a study titled *Atlantic Region Freight Assistance Program, Information Paper* to measure the effects of the program. We reviewed the *Information Paper* and found it to be, within the limitations of the state of the art for such studies, sound and reliable.

6.10 In the Intra-regional subprogram, the courts have taken a narrow interpretation of the regulations on assessing the eligibility of movements involving non-arm's length shippers and carriers. The Agency recommended changes to the regulations, but no action was taken.

6.11 Deregulation of freight rates in the late 1980s has resulted in a growth in the number of shippers and carriers operating at less than arm's length. Because the rates charged by these carriers are not subject to the discipline of the market place, there is a danger that they may be inflated to attract larger subsidies.

6.12 The cumulative effect of the growth in rate deregulation and in the number of non-arm's length shipper-carriers was that the program's structure, which was designed for another era, was increasingly ill suited to the state of the industry it was subsidizing.

6.13 The Agency does not assess the reasonableness of the freight charges submitted to it for subsidy. It believes that it does not have the authority to do so.

6.14 It will be important to ensure that controls over subsidy payments are rigorously enforced during the program wind-up period.

Part I: A Profile of Subsidies to Transportation

Introduction

6.15 Canada has a long history of public subsidization of transportation. That history resulted in direct subsidy payments by the federal government of an estimated \$1.6 billion for transportation in 1994–1995. Net federal indirect subsidies to transportation are estimated to have cost \$0.8 billion for the same period. The purpose of this audit was to examine the operations of two of the major federal direct subsidy programs for surface freight: the *Western Grain Transportation Act* Program and the Atlantic Region Freight Assistance Program. In 1993–94, according to the Public Accounts, the government spent \$633 million and \$106 million respectively on these two programs; they represent the largest of the direct non-passenger-related subsidies paid by the federal government. We last reviewed these subsidies in 1987; based on that fact as well as the concerns about transportation subsidies raised by the National Transportation Act Review Commission in its 1993 report, we concluded that it was timely to audit these programs again.

6.16 As part of our audit work, we compiled the most recently available information on federal transportation subsidies to provide a framework within which to assess the two programs. The first section of this chapter provides a summary of this information, which we believe provides a useful context for what follows. The second section reports on the results of our work on the *Western Grain Transportation Act* Program, and the third section presents the results for the Atlantic Region Freight Assistance Program.

What is a transportation subsidy?

6.17 A transportation subsidy is a direct or indirect transfer of resources from the government to the enterprises engaged in the provision of transportation or to the users of transportation services. The subsidy provided usually confers an advantage to the users or encourages them to engage in an activity that they would otherwise not choose. The general aims of transportation subsidies are:

- to ensure adequate provision of transportation services that are deemed to be desirable to the public interest; and
- to provide economic or social benefits to specific groups, users or regions — usually to lower the price paid for transportation.

6.18 There are two major types of subsidy:

- **indirect** — the net expenditure for the provision by a government department, agency or Crown corporation of a transportation-related service or infrastructure that benefits a specific group.
- **direct** — a direct payment to a specific group (usually a carrier but including a Crown corporation or other non-departmental government agency).

What is the Federal Government's Role in Transportation Subsidies?

Background

6.19 Transportation subsidies have been introduced for a variety of purposes: to contribute to nationhood, to redistribute income or to promote economic efficiency. Many of the early rail and road projects were put in place to connect and unify the country. They gave people access to goods and services in the locations connected. Many subsidy programs were intended to contribute to regional development. In most cases, transportation subsidies were introduced for reasons of what was thought

The purpose of this audit was to examine the operations of two of the major federal direct subsidy programs for surface freight: the *Western Grain Transportation Act* Program and the Atlantic Region Freight Assistance Program.

to be economic efficiency. They made transportation available to companies and individuals who, on their own, could not have afforded the service. They also reduced the price paid for transportation, making goods and services available at reasonable cost to additional markets. Some transportation subsidies have been criticized for distorting market signals and discouraging competition.

6.20 In the following sections, we present a brief description on a modal basis of the major federal transportation subsidization activities.

6.21 Rail. Government subsidization of railway construction is a well-documented feature of Canada's development. One of the more famous of these involvements by the government, the "Crow rate", provided farmers with a fixed rate for transporting grain produced in Western Canada for export. The Crow's Nest Pass rates remained largely unchanged between 1897 and 1982.

6.22 The rates worked until the 1960s when the major railways, which were losing money on grain traffic, began to let their grain rolling stock and least profitable lines deteriorate. Accordingly, the capacity to transport prairie grains to ports was reduced and sales were lost. In the 1960s and 1970s, ad hoc programs were introduced to subsidize the railways.

6.23 The *Western Grain Transportation Act* (WGTA) was enacted in 1983 and became effective January 1984. It established a comprehensive program for the transportation of Western grain and paid a subsidy to the railways for transporting grain to specified export locations.

6.24 The major subsidy to passenger rail is the VIA Rail subsidy that subsidizes operating losses of the railway. According

to the 1994-95 Estimates, the subsidy will be \$331 million for that year. VIA was incorporated in 1977 to provide for passenger rail transportation services across Canada. Before that, the *Railway Act* of 1967 subsidized up to 80 percent of approved losses on passenger services provided by CN and CP.

6.25 Road. Until the 1950s, federal subsidization of road building was sporadic. In the 1950s, the federal government became heavily involved in the Trans-Canada Highway project, with its contribution peaking at 16 percent of provincial dollars in 1967. According to the Estimates, the Department of Transport's expenditures on roads will be \$275 million in 1994-95, approximately the same amount in current dollars as the 1967 figure. This figure includes \$128 million for the Strategic Capital Investment Initiative.

6.26 Air. Federal involvement in air transport dates back to the 1930s and the creation of Trans Canada Air Lines, the predecessor to Air Canada, as a wholly owned federal government body. In the 1950s and '60s, the federal government constructed more than 100 airports. In the 1980s and '90s, the government started the process of commercialization. Air Canada was privatized and four major airports were transferred to Local Airport Authorities. Based on the Estimates, the net indirect subsidy to aviation through the provision of airports and aviation services is \$175.8 million in 1994-95.

6.27 Marine. The federal government has been involved in marine transportation from the time of Confederation. It continues to provide a substantial indirect subsidy by maintaining major inland waterways and providing marine services, such as ice breaking, at a cost estimated at \$117 million in 1994-95.

6.28 The federal government has also been heavily involved in subsidizing marine traffic on ocean waters. At Confederation, both Prince Edward Island and Newfoundland were given commitments that the federal government would provide ferry freight and passenger services. A primary role of Marine Atlantic (1994–95 Estimates: \$128 million) is to continue to fulfill these obligations. The net subsidy to the Marine Program, which includes ice breaking but is additional to the Marine Atlantic subsidy, is estimated at \$575.7 million in 1994–95.

Significant Recent Events Relating to Transportation Subsidies

6.29 The 1987 *National Transportation Act* declared that a safe, efficient and adequate system is most likely to be achieved when all carriers are able to compete both within and among the various modes of transportation. There was a strong emphasis on the need for transportation decisions to be governed by market signals.

6.30 The federal government also enacted the *Motor Vehicle Transport Act* in 1987. It resulted in a gradual dismantling of provincial regulatory controls over the trucking industry.

6.31 The 1993 *National Transportation Act* Review Commission reviewed the results of the 1987 reforms. It concluded that the regulatory reforms of 1987, while subject to continuous refinement, were correct, had not affected safety and had been particularly successful in the freight service area, where costs had declined. The Commission declared that the withdrawal of government from the direct management of the transportation sector, and from balancing economic interests

through regulation was timely and appropriate policy.

6.32 The Review Commission report was particularly caustic on the subject of transportation subsidies, stating:

Government programs which defy market forces by subsidizing some transportation services, and restricting the rationalization of others, perversely prevent the development of economically sound — and therefore sustainable — modes of transportation. In the end, such policies produce — and have produced — costly inefficiencies that result in reduced standards of living as we spread cost-inefficiencies throughout the Canadian economy, pricing our goods out of the global market. The resulting economic and social hardship works to the disadvantage of all Canadians, including those living in regions intended to benefit from such programs. (Review Commission Report, 1993: Vol.1, 146–7)

Subsidies change the behavior and structure of markets. They act as artificial stimulants which undermine entrepreneurship and cost-efficiency by promoting otherwise inefficient decisions or activity. In short, subsidies can be detrimental to the long-term needs of shippers, carriers and the economy. (Review Commission Report, 1993: Vol.1, 151)

6.33 The Review Commission made two recommendations directed at transportation subsidies:

Recommendation 34. We recommend that the Government of Canada assess all transportation subsidies with a view to eliminating or restructuring those which cannot be justified or those which work inefficiently in their present form.

Subsidies can be detrimental to the long-term needs of shippers, carriers and the economy.

Recommendation 35. We recommend that subsidies whose objective is to support sectors other than the carrier industry should be paid directly to such sectors and not through budgetary allocations to transport, or through obligations imposed on carriers.

6.34 On 27 February 1995, the government announced the termination of two of the largest transportation subsidies: the *Western Grain Transportation Act* subsidies will end on 1 August 1995, and the Atlantic Region Freight Assistance subsidies will end on 1 July 1995. The implications of these changes and their effect on our audit are discussed in the sections of the chapter dealing with these two programs.

Current Status

6.35 The following exhibit displays total (direct and indirect) federal transportation subsidies. Total federal transportation subsidies (adjusted for changes in the Consumer Price Index) declined from \$3,020 million in 1988–89 to \$2,083 million in 1992–93 (approximately two thirds of the 1988–89 level). The 1994–95 adjusted estimates of expenditure were virtually unchanged from

the 1992–93 actual levels. The chart also shows that the unadjusted figures (total subsidies line) declined over the same period (to four fifths of the 1988–89 level). (The Appendix to this chapter contains a detailed program-by-program breakdown of federal subsidies to transportation.)

Direct Transportation Subsidies

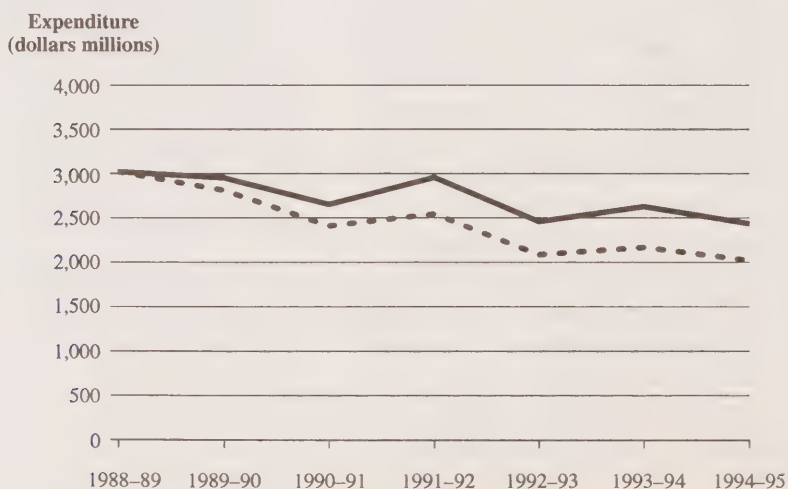
6.36 The Department of Transport, its associated agencies and Crown corporations provided direct subsidies to more than 20 programs in 1994–95. Exhibit 6.2 displays direct subsidy expenditures from 1988–89 to 1994–95. The exhibit shows that the actual transportation subsidies figures (direct subsidies line) experienced a similar pattern of decline. Direct transportation subsidies, that is, direct payments to specific groups, declined on an adjusted basis from \$2,022.9 million in 1988–89 to \$1,398.5 million in 1992–93, or to just over two thirds of their 1988–89 level. Reductions to VIA Rail accounted for \$297 million of the \$624.4 million reductions, almost one half of the total. Reductions to the *Western Grain Transportation Act* payments accounted for \$165 million, or 26 percent of the total. The elimination of the “At and East”

Exhibit 6.1

Total Direct and Indirect Federal Transportation Subsidies

In Current and Real (1988)
Dollars from 1988–89 to
1994–95

— Total Subsidies
- - - Cpi Adjusted



Source: Public Accounts, Estimates,
and OAG study of indirect expenditures

Program accounted for an additional six percent or \$40 million in reductions.

Indirect Transportation Subsidies

6.37 The Marine Program includes the activities of the Canadian Coast Guard. The Coast Guard fleet consists of 103 vessels of various types, including 17 light, medium and heavy ice-breaking vessels. The fleet installs, services and supplies thousands of aids to navigation along Canada's coastal and inland waterways. During winter, icebreakers support commercial shipping in the Gulf of St. Lawrence. Ice-breaking costs totalled \$700 million over the period 1988–89 to 1992–93. Search and rescue operations are carried out by Canadian Coast Guard ships and life boats. Each year the Coast Guard is involved in marine search and rescue incidents. During the period 1989–90, it played a key role in 12 percent of the 1,594 recorded distress incidents. Search and rescue costs totalled \$429 million over the period 1988–89 to 1992–93 and were estimated at \$80 million in 1994–95. Marine program revenues totalled \$216.1 million over the period 1988–89 to 1992–93 (6.5 percent of expenditures) and

were estimated at \$26 million in 1994–95 (4.3 percent of expenditures).

6.38 The Airports and Aviation Programs, with approximately 10,000 people, are responsible for providing and operating national and international airport facilities and air traffic control services. The Aviation Program operates about 70 traffic control towers, seven area control centres and eight terminal control units. The Airports Program is currently involved in the operation of 149 national, regional and local airports. The Airports and Aviation Programs expended \$6,536 million over the period 1988–89 to 1992–93 and planned to expend \$1,145 million in the year 1994–95. Revenues totalled \$5,459 million from 1988–89 to 1992–93 (83.5 percent of expenditures) and were estimated at \$970 million in 1994–95 (84.7 percent of expenditures).

Which Modes of Transport Are Most Heavily Subsidized?

Total subsidies by mode

6.39 Exhibit 6.3 displays the modal share of the total federal transportation subsidy expenditure for the years 1988–89

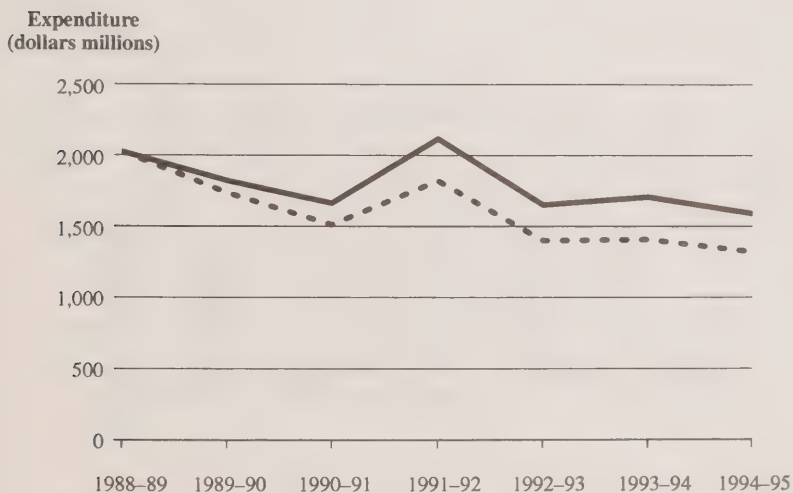


Exhibit 6.2

Total Direct Federal Transportation Subsidies

In Current and Real (1988) Dollars from 1988–89 to 1994–95

— Direct Subsidies
 - - - CPI Adjusted

Source: Public Accounts and Estimates

to 1992–93. It is noteworthy that on a gross subsidy basis, rail and air each receive just over a third of the federal subsidy expenditures.

6.40 Exhibit 6.4 displays the total federal and provincial subsidy expenditures by mode of transportation (actual figures for the years 1988–89 to 1992–93 and budget estimates for the years 1993–94 and 1994–95).

6.41 As the exhibit indicates, the government expenditure on road transportation accounts for more than the three other modes combined (55 percent of

the total for the years 1988–89 to 1992–93). The share of the other three modes over the same period was 17 percent for air, 16 percent for rail and 12 percent for marine.

Net subsidies by mode

6.42 Exhibit 6.5 displays the net federal transportation subsidies by mode for the years 1988–89 to 1992–93. On a net subsidy basis, rail (50 percent) is the most highly subsidized federally. Offsetting revenues reduce the air mode's share of net subsidies from 34 percent to 8 percent. The lack of offsetting revenues increases the marine mode's share of net subsidies from 25 percent to 35 percent. On both a gross and net basis, the federal share of road transportation subsidies is very small. This reflects the fact that roads are largely a provincial responsibility.

6.43 Exhibit 6.6 displays the net federal and provincial subsidies by mode for the years 1988–89 to 1992–93.

6.44 Provincial road transportation expenditures are more than offset by provincial fuel tax revenues. The rail (\$6,238 million) and marine (\$4,924.1 million) modes received the

Exhibit 6.3

Modal Share of Total Federal Transportation Subsidies (1988–89 to 1992–93)

Source: Public Accounts, Estimates and OAG study of indirect expenditures

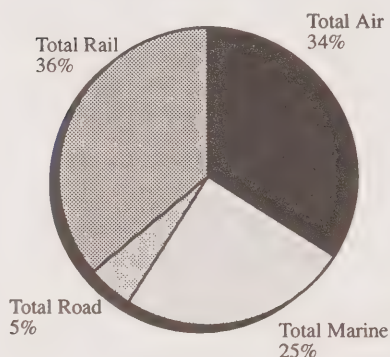
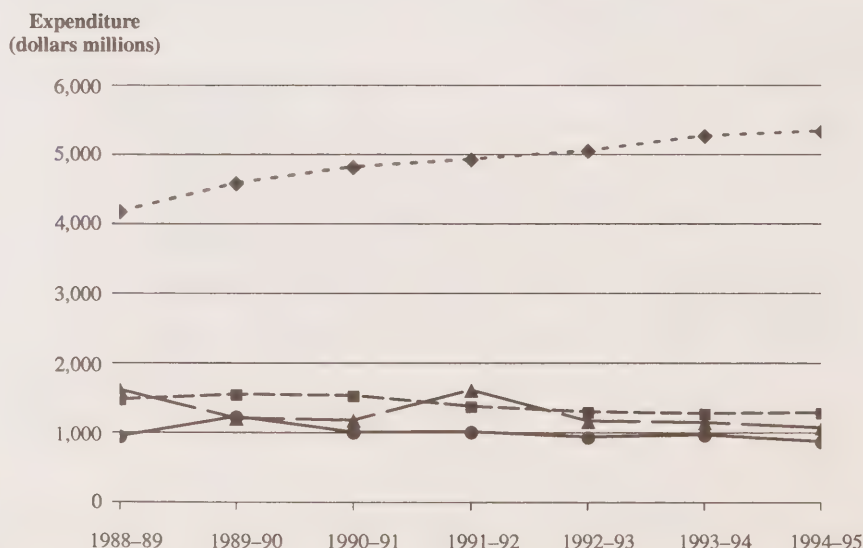


Exhibit 6.4

Total Federal–Provincial Subsidies by Mode 1988–89 to 1994–95

—■— Air
—◆— Marine
- - -◆- - - Road
—▲— Rail

Source: Public Accounts, Estimates, and OAG study of indirect expenditures



highest net combined federal-provincial subsidies over the period 1988–89 to 1992–93.

Estimating and Measurement Issues

6.45 The estimation of costs involved a number of assumptions. Indirect expenditures were allocated to modes based on formulae developed by the Cost Recovery Branch of the Department of Transport. The formulae are the same as those used in the *National Transportation Act Review Commission* report on subsidies.

6.46 Information on modal shares of gross and net federal and federal-provincial expenditures has been provided. Information on subsidies on a per tonne-kilometre and passenger-kilometre basis has not been provided; however, that information would provide additional assistance in determining the economic efficiency of subsidies. The 1993 Transport Canada Data Needs Review identified problems with data estimates of tonne- and passenger-kilometres, particularly road and

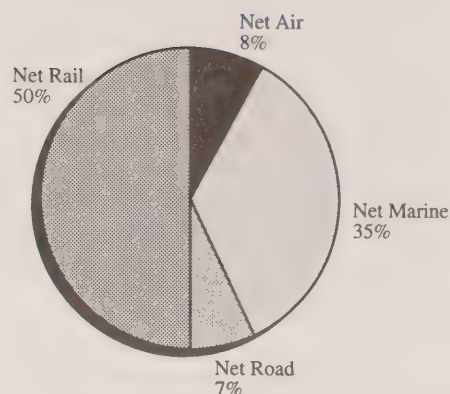


Exhibit 6.5

Modal Share of Net Federal Transportation Subsidies (1988–89 to 1992–93)

Source: Public Accounts, Estimates and OAG study of indirect expenditures

rail data. The Royal Commission on Passenger Transportation produced illustrative cost per passenger-kilometre data by mode but pointed out the serious limitations in the existing data. In view of the limitations stated, we have not provided these data.

Overall Audit Scope and Objectives

6.47 The purpose of this audit was to examine the two major freight surface transportation subsidy programs: the Atlantic Region Freight Assistance

Expenditure (millions)

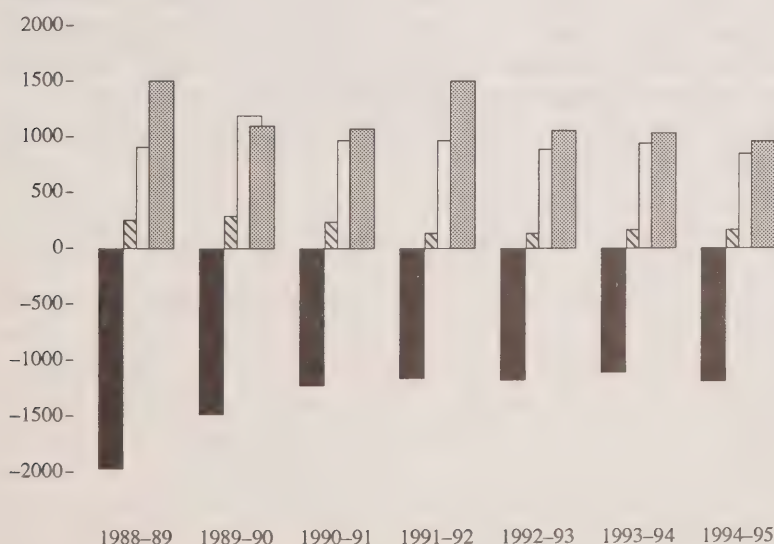
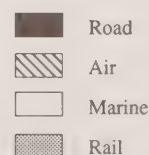


Exhibit 6.6

Net Federal-Provincial Transportation Subsidy by Mode (1988–89 to 1994–95)



Source:
Federal Data: Public Accounts, Estimates, and OAG study of indirect expenditures
Provincial Data: Provincial Public Accounts

Program and the *Western Grain Transportation Act* Program.

6.48 The objectives of the audit were:

- To provide Parliament with a description of the extent of federal government subsidization of inter-urban transportation of goods and people; and, to the extent practical, to provide information on provincial expenditures for that transportation.
- To assess the administration of the Atlantic Region Freight Assistance Program and the *Western Grain Transportation Act* Program and to report appropriate significant deficiencies in delivery results (wrong cheque, person or time) and/or controls.
- To assess management's measurement and reporting of results of the Atlantic Region Freight Assistance Program and the *Western Grain Transportation Act* Program in relation to its legislated and managerial responsibilities; and to report appropriate deficiencies.
- To conduct a review to provide limited assurance to Parliament on the reliability of the Department of Transport's *Information Paper* on the Atlantic Region Freight Assistance Program.
- To review the role of the Grain Transportation Agency in the Western grain transportation system, to describe for Parliament the key elements of that role, to report appropriate deficiencies to

Parliament and to report on the Agency's response to the observations made in our 1987 annual Report.

6.49 In carrying out our audit, we expected to find that:

- program objectives were clear and consistent and that program results and effects were known and measured;
- periodic program evaluations of the two major subsidies had been conducted;
- payments pursuant to the *Western Grain Transportation Act* were related to an adequate, reliable and efficient grain transportation system and the performance of system participants was being monitored;
- the National Transportation Agency had adequate controls for determining rates, reviewing costs, reviewing railway investments, determining eligibility for payments and making payments under the *Western Grain Transportation Act*; and
- the Atlantic Region Freight Assistance Program had adequate controls in place to determine eligibility for payments and for making payments.

6.50 Quantitative information. The quantitative information in this chapter has been drawn from the various government sources indicated in the text. However, unless otherwise indicated, this quantitative information has been checked for reasonableness but not audited.

Part II: The Western Grain Transportation Act Program

Introduction

6.51 The *Western Grain Transportation Act* (WGTA) was enacted in 1983 to reform the administration of the “Crow rate” by creating a complete program to facilitate the transportation, shipping and handling of Western grain to export markets. The Act works together with other legislation, government agencies, producers, railways and private interests to comprise Canada’s grain transportation and handling system (see Exhibit 6.7). Although the WGTA subsidy is perhaps the best known element of this program, it is only one part of a complex system.

Background

6.52 The origins of the *Western Grain Transportation Act* lie in a 1897 agreement by the federal government to subsidize the Canadian Pacific Railway to construct a line through the Crow’s Nest Pass. In return, the “Crow rate” was capped at 0.5 cents per ton-mile for grain products moving eastward on the Canadian Pacific Railway. In 1925, the rates were regulated and subsequently extended to every prairie shipping point, railway, export port, grain byproduct and oilseed.

6.53 The “Crow rate” did not keep pace with other rates and, in 1961, the MacPherson Royal Commission reported that the railways were losing money transporting grain. The railways responded to this situation by deferring maintenance and investing less in related equipment and infrastructure, thus reducing their capability to respond to increasing volumes of grain exports.

6.54 In the 1970s and 1980s, the federal government responded by subsidizing the operation of unprofitable branch lines, and funding the rehabilitation of many grain-dependent branch lines that had fallen into a state of disrepair. To protect its investment, the government issued prohibition orders that put a moratorium on the abandonment of grain-dependent prairie branch lines until the year 2000. The government also purchased 13,000 hopper cars designed for hauling grain to increase the efficiency of the grain car fleet.

Western Grain Transportation Act, 1983

6.55 Despite these federal initiatives, the railways continued to lose money at the “Crow rate” and there were increasing grain transportation problems. In 1981, the government established a task force headed by Clay Gilson to examine all aspects of the issue. In 1982, the Gilson Report identified the revenue shortfall for the railways at \$658.6 million for the 1981-82 crop year and recommended widespread changes to the entire grain delivery system.

6.56 To respond to the problems and to put a cap on government funding, the *Western Grain Transportation Act* was passed in 1983. On the one hand, the Act provided that the railways would be fully compensated for the costs they incurred in moving grain through a regulated rate and the government would subsidize shippers for a significant share of those costs. On the other hand, the Act also included important safeguards to ensure that the railways, in particular, responded to the revenue guarantees by making the appropriate investments and operational commitments necessary to provide an efficient, reliable and adequate grain transportation system. Responsibility for these elements of the program was assigned to the Canadian Transportation Commission, which is now the National

Transportation Agency. Because the system would operate on regulated rates outside the disciplines of the market place, the government recognized the need to provide a substitute in the form of a system of performance measurement to track the performance of system participants and a process to allocate scarce resources such as grain cars. These duties were assigned to the Grain Transportation Agency.

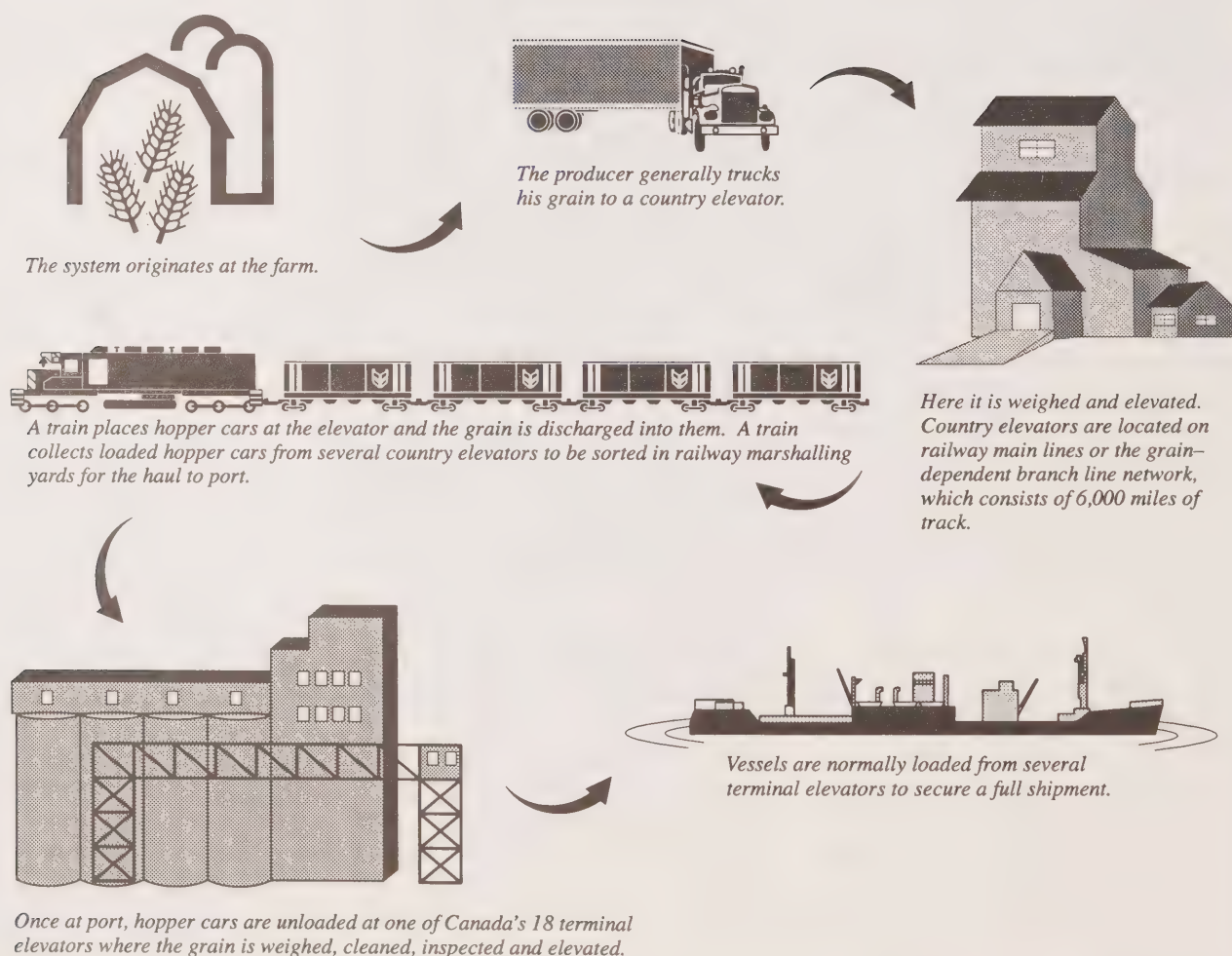
The 1995 Budget

6.57 In the 1995 Budget, the government announced that it was reforming the Western grain transportation system. The system reform will affect how grain transportation is managed in a number of ways, including:

- The *Western Grain Transportation Act* will be repealed.

Exhibit 6.7

The Grain Transportation and Handling System



- Grain traffic will be covered by the *National Transportation Act*.
- The subsidy to the railways under the *WGTA* will be terminated effective 1 August 1995.
- Maximum rates for the transportation of grain will be regulated during the transition period to 31 July 2000.
- The role of the National Transportation Agency in rate and payment matters will be eliminated except for the calculation of the adjustments to the maximum rates.
- The Grain Transportation Agency will be eliminated as a legislated body. However, reporting to Transport Canada, the organization will continue those operational, planning and co-ordination duties required by the Western grain transportation system until they can be transferred to an industry body.

Audit Scope and Objectives

6.58 The focus of our audit was to examine the way in which the Grain Transportation Agency (GTA) and National Transportation Agency (NTA) were carrying out their responsibilities under the *Western Grain Transportation Act* (see Exhibit 6.8) and to determine whether there were matters that should be brought to the attention of Parliament. Although the reforms will abolish or transform key elements of these agencies, we believe that there is still value in reporting certain of our observations to Parliament – either because the problems that these agencies face remain for the reformed system to deal with, or for purposes of accountability.

6.59 The Grain Transportation Agency was created in 1979 as a co-ordinating body, and then given additional duties and agency status with the passage of the

Western Grain Transportation Act. The duties of the Agency include:

- preparing the annual tonnage forecast for the movement of grain in the coming crop year. This forecast is the basis for the annual rate calculation by the National Transportation Agency;
- establishing performance objectives for the system participants and monitoring performance against those objectives;
- ensuring that there is an adequate supply of rolling stock for the efficient movement of grain;
- managing the government's fleet of hopper cars on behalf of the Minister and, under the authority of the *Canada Grain Act*, making the weekly allocation of cars between the Canadian Wheat Board and other shippers; and
- conducting studies of the system either on its own initiative or at the request of the Senior Grain Transportation Committee.

6.60 The National Transportation Agency was created in its present form by the 1987 *National Transportation Act*. The Agency has a wide variety of duties related to transportation. Among those duties assigned to it under the *Western Grain Transportation Act* are:

- setting annual rates for the movement of Western grain;
- conducting the quadrennial costing review of the railways' costs of moving grain, the results of which are used to adjust the cost base that is used in setting annual rates;
- making the subsidy payment to the railways based on the government's share of the rate;
- receiving and assessing the annual investment plans of the railways. The Agency must report to the Minister on whether those plans are appropriate for ensuring an adequate, reliable and efficient

rail transportation system for the movement of grain; and

- auditing actual capital expenditures and maintenance costs related to branch lines.

6.61 The *Canadian Wheat Board Act* gives the Board control over the sale and transportation of wheat and barley, which represent over 70 percent of total grain production. We note the significant role that the Canadian Wheat Board plays in the system. However, the Board is one of the few Crown corporations that we do not audit and thus its operations fall outside our mandate. An audit of the grain handling and transportation system would require the inclusion of the Board in the audit scope.

Observations and Recommendations

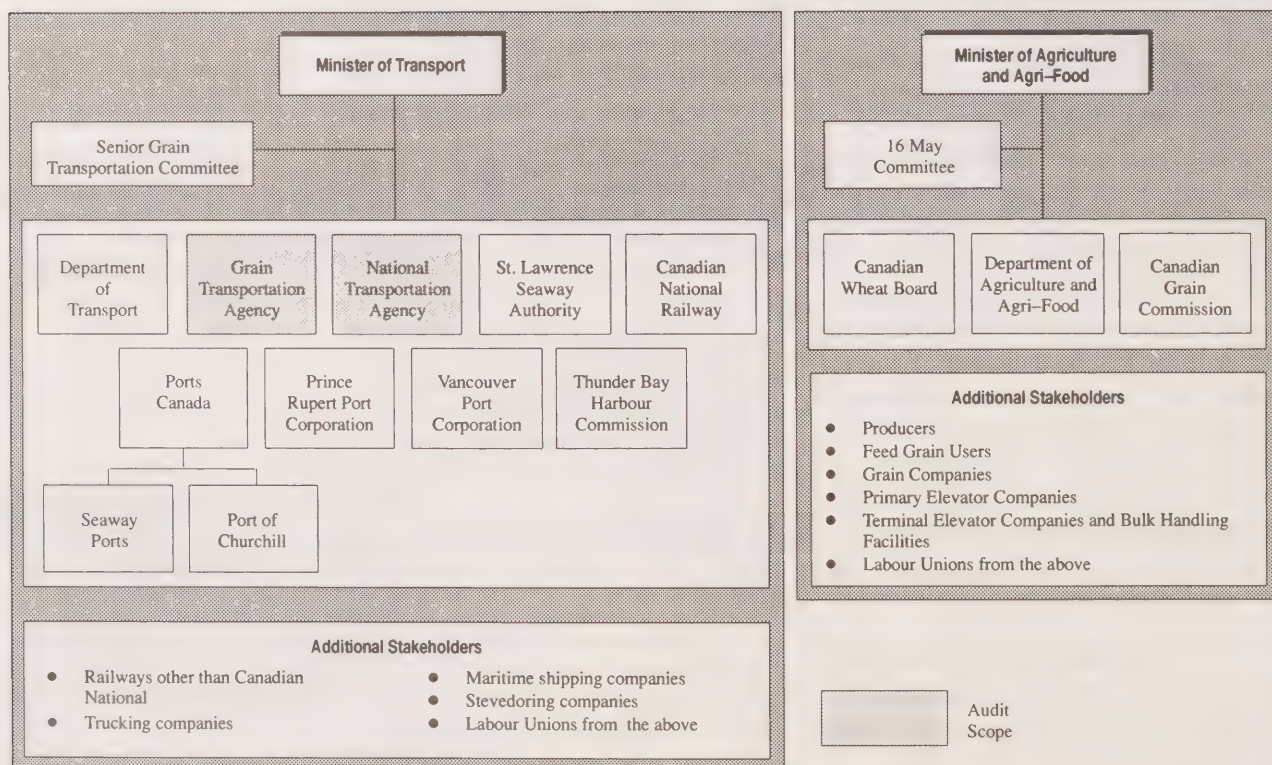
The Grain Transportation Agency

Annual grain forecast improved

6.62 The Grain Transportation Agency is required to develop the annual grain tonnage forecast, which is then provided to the National Transportation Agency for the purpose of calculating the annual rate scale. The forecast is the GTA's estimate of the tonnage of grains that will be eligible for the subsidy under the *Western Grain Transportation Act* for the upcoming crop year. In 1987, we recommended that the GTA disclose the variance or range associated with its statistical forecast and

Exhibit 6.8

Audit Scope and Responsibilities for Grain Transportation and Handling



examine other forecasting approaches to determine whether the forecast variance or range can be reduced. We found that the GTA had responded positively to our recommendations by improving its forecasting approach.

Performance monitoring inadequate

6.63 The *Western Grain Transportation Act* requires the Grain Transportation Agency to develop performance objectives for grain transportation, shipping and handling that can and should be met by system participants. The Agency is also required to monitor the performance of the railways and any other system participants that the Agency deems appropriate, to determine whether they are meeting the performance objectives set for them. The Agency is further required to develop a notional scheme of awards and sanctions applicable to the railways and other system participants. It is to be applied in relation to the extent that they meet or fail to meet the performance objectives. The Act also requires the Agency to propose to the Minister, for possible implementation, an actual scheme of awards and sanctions, and to recommend to the Minister whether it is advisable to implement the scheme.

6.64 In 1994, we expected that the provisions of this part of the Act would have been fully implemented by the Agency. We found that this was not the case. To respond to this requirement, the Agency turned to the Senior Grain Transportation Committee, a body created by the *Western Grain Transportation Act* to advise the Agency and the Minister on grain transportation matters. The Agency asked the Committee to recommend and update over time a system of realistic and practical performance objectives and measurement criteria for system participants.

6.65 The Senior Grain Transportation Committee is comprised primarily of representatives of the grain producing, shipping and transportation community. In essence, it is a committee of “system participants”. Exhibit 6.9 shows the composition of the Committee. The Committee accepted a report dated 27 December 1984 from its Subcommittee on Performance Objectives. This report recommended a single overall system target: tonnes unloaded by port. It also recommended that a detailed analysis of performance be done when performance fell below 95 percent and that notional sanctions be applied when performance fell below 91 percent of target. Performance measurement was to be done on an exception basis and the Subcommittee outlined a basic system of notional awards and sanctions. In sum, the collective view of the industry, as expressed through the Senior Grain Transportation Committee, was a preference for a much less rigorous and less specific monitoring of its performance than was specified in the Act.

6.66 According to the Agency, it has followed the recommendations of the Senior Grain Transportation Committee in developing only one basic operational measure for the system, which it calls “target unloads”. For each of the major export points for grain — Vancouver, Prince Rupert, and Thunder Bay — the Agency sets a monthly target for the number of tonnes of grain to be unloaded from hopper cars. The Agency’s measurement of performance consists of tracking the actual number of tonnes unloaded and expressing that number as a percentage of the target. When the ratio of actual unloads to target unloads falls below 95 percent, this triggers a performance review that looks at operational issues in greater detail. If the ratio falls below 91 percent, notional penalties are discussed with the Senior Grain Transportation

A global measure, such as the percentage of target unloads, provides no basis for determining causes or assessing the contribution of the various participants.

Committee. Although, according to the Agency, the performance reviews have been helpful in identifying possible system improvements, in our view they do not respond to the requirements of the Act. The Agency does not currently maintain any system of notional awards and sanctions.

6.67 In our opinion, while the percentage of target unloads is not, in itself, a bad measure of overall system performance, it is inadequate for the purposes envisaged by the Act. The grain transportation system is complex, and because every shipment involves the participation of many participants, when targets are missed by a material amount the failure is seldom unidimensional. A global measure, such as the percentage of target unloads, provides no basis for determining causes or assessing the contribution of the various participants. Additionally, because the target is global, no specific system participant can be held accountable when system targets are not met. As noted above, the performance reviews do look at individual performance when there is a

failure, but because the standard of performance for the individual participants involved must inevitably be arrived at on an after-the-fact basis, it becomes difficult, in fairness, to sanction the participant, either notionally or actually, on that basis.

6.68 Because the Grain Transportation Agency has not set performance targets for system participants, it has no basis on which to hold the participants accountable for their contributions to the system's performance, and thus no valid basis on which to develop the system of awards and sanctions that it was required to develop. The Agency has informed us that in choosing not to implement such a system, it has accepted the view of the industry, as expressed by the Senior Grain Transportation Committee, that to have developed such a system would have been both impractical and undesirable. In this context, it must be noted that the Agency has never attempted to do other than what was recommended to it by the Senior Grain Transportation Committee, and hence does not know what would have happened had it attempted to fully implement the

Exhibit 6.9

Senior Grain Transportation Committee Membership

Chief Commissioner Canadian Wheat Board	Chief Commissioner Canadian Grain Commission	Administrator Grain Transportation Agency	One member other primary elevator licensees	One member Canadian Pacific Railway
Two members producers of Saskatchewan	Two members producers of Alberta	One member producers of British Columbia	One member feed grain users in other provinces	One member Great Lakes Grain Carriers
One member – feed grain users in Manitoba, Saskatchewan, Alberta	One member – labour in the handling and transportation of grain	One member – producers where Canadian Wheat Board permit not required	One member Canadian National Railway	
Two members producers of Manitoba	Six members six largest primary elevator licensees	One member Canadian Trucking Industry	One member process elevators in Western Division	

requirements of the Act. Unfortunately, since the completion of the studies that led to the requirements for a performance monitoring system being placed in the Act by Parliament, there has been no independent assessment of either the desirability or practicality of complying fully with the requirements of the Act.

6.69 The changes announced in the Budget will introduce new market forces to the system. However, as we discuss below, many aspects of the system, including rates and car allocation, remain regulated. Until these aspects of the system are also market-driven, there will continue to be a need for performance measures to enable the government to know and respond to the effects of the administered elements of the system.

The Grain Transportation Agency states: Its view on the impracticality and undesirability of a system of performance objectives coupled to notional awards and sanctions is based on the fact that the grain marketing and transportation environment is dynamic; a detailed set of performance targets for individual participants might be the optimal plan when it is established, but in reality things rarely go exactly according to plan. System participants must be willing and able to adjust their operational plans as required, as plans change. The establishment of a detailed set of performance targets for individual participants, subject to sanctions for variance from those objectives, could lead to an inflexible operating environment. Individual participants might focus operationally on protecting their individual performance in relation to their performance targets, to the potential detriment of overall system performance, and participants might be less willing to share information for fear of having that information used to later justify a sanction. In addition, the Agency notes that the

interdependence of one participant's performance on other participants' actions would make it extremely difficult to "prove the point" that a particular participant was responsible for a performance shortfall and therefore subject to a sanction. Therefore, a performance monitoring process based on individual participant targets could quickly break down in mutual "finger pointing" with a potentially negative result for system efficiency, adequacy and reliability. It is the Agency's opinion that for the Administrator to have pursued implementation of detailed individual participant performance objectives and corresponding notional sanctions would have been in contravention of his obligation under section (17)(2) of the Act.

Car allocation

6.70 The grain-dedicated hopper car fleet. The federal government owns and the GTA administers a fleet of 13,000 hopper cars, with a new replacement cost of roughly \$800 million. In addition to that fleet, the Canadian Wheat Board administers 2,000 hopper cars that it owns, as well as 2,000 cars that it leases but that are paid for by the Department of Transport. Another 1,000 cars are owned and administered by each of the governments of Saskatchewan and Alberta, bringing the total grain-dedicated fleet to 19,000 hopper cars. The railways supplement this fleet with cars they own and lease as deemed necessary.

6.71 Current allocation process. Car allocation is a major system function that has been left largely unresolved by the changes flowing from the Budget. The Grain Transportation Agency is assigned responsibility under the *Canada Grain Act* for allocating the entire available fleet of grain cars. According to the Agency, this role is rooted in the regulation of rates for rail movements of grain. The maximum rate regulation (both under the WGTA and

the proposed regulation that will exist in the transition period following the repeal of the *WGTA*) is, according to the Agency, based on two factors. First, there is the perception that the market structure for grain transportation by rail is not sufficiently competitive. Second, there is the fact that over 70 percent of the grain hopper fleet is provided at no capital cost to the railways. Because scarce transportation and/or handling capacity cannot be rationed through rate increases, they must be rationed according to a set of rules. The Grain Transportation Agency consults with industry to develop the rules, and is then responsible for the administration of those rules.

6.72 The Grain Transportation Agency divides the available cars between the Canadian Wheat Board and the rest of the industry. Each week, the GTA meets with the railways and the Wheat Board to determine the number of cars that will be available in two weeks time.

6.73 The Agency then makes an initial division between the Wheat Board and non-Wheat Board loading programs. When there is a shortage, the allocation of the number of non-Board cars to various companies is based on sales or market share. The railways, the Wheat Board and the grain companies are informed of the allocations and they determine the specific routing of the cars. According to the Wheat Board, it co-ordinates the movement of rail cars to individual train runs under the Industry Rail Car Allocation Policy. This is an agreement among the grain companies, the railways and the Board for the placement of cars at country loading points. The Board's role is a function of its responsibility for over 70 percent of the total grain movement, and its mandate to ensure equitable delivery opportunities for all Western grain producers.

Ensuring an adequate supply of rolling stock

6.74 The *Western Grain Transportation Act* requires that the Minister of Transport take every reasonable initiative to ensure that an adequate supply of rolling stock will be provided for the efficient, reliable and effective movement of grain. This responsibility has been assigned to the Grain Transportation Agency.

6.75 The Agency prepares estimates of the number of railway-supplied hopper cars required, over and above the grain-dedicated hopper car fleet, to meet movements forecast for the coming crop year. The Grain Transportation Agency estimates that the dedicated hopper car fleet is generally capable of moving 28 million tonnes of grain annually. So, in any year where exports are likely to exceed this amount, additional capacity will be required. The GTA also estimates seasonal movement demand and car requirements and forwards these estimates to the railways. If the predicted volumes exceed the base car fleet capacity, the railways are told of the need to acquire additional hopper cars.

6.76 **System problems during the 1993–94 crop year.** Capacity shortages are not new to Canada's grain transportation and handling system, but had not been a major concern since the passage of the *Western Grain Transportation Act*. However, problems during the 1993–94 crop year have raised several issues, including whether a sufficient number of hopper cars are in service to handle grain volumes, the degree to which a lack of pricing factors may play a role in the demand for cars and the degree to which the system as a whole has reached its capacity.

6.77 During the fall of 1993 and the winter of 1994, there were serious

interruptions in the transportation of Western grains to market. It has been suggested by the Grain Transportation Agency that those disruptions may have cost Canada losses in terms of sales not made and delayed shipments that may have damaged its reputation as a reliable supplier of grains to world markets. As outlined briefly below, some of the causes of the 1993–94 problems were unique to that year. The 1994–95 season is forecast to move record volumes, but there have been difficulties in achieving this. Some of the difficulties are systemic and rooted in features of the WGTA program that have not yet been addressed in the current reform.

6.78 The events of 1993–94. As early as April 1993, the Grain Transportation Agency had estimated that additional cars and/or significant reductions in car cycle times would be required if car shortages were to be avoided during the upcoming year. In July, the Agency issued a report that concluded that the railways did not have enough hopper cars to meet the demand. In August, it warned that the railways were between 1,200 and 4,100 hopper cars short of demand requirements. The Agency indicated that for the peak shipping period — November and December — the railways would need 8,000 and 7,000 additional cars, respectively. The railways, however, used more optimistic cycle times and more pessimistic sales projections to put the additional requirement at 4,000 and 5,000 respectively for those two months. According to the Agency, the lack of a timely response by the railways was one of the reasons for the system problems in the 1993–94 crop year. However, a series of other difficulties added to the problems:

- Flooding in the United States Midwest adversely affected shipping on the Mississippi River, creating a continental

shortage of hopper cars, and made it difficult and costly for Canadian railways to lease additional cars. The floods also reduced crop yields and increased demand for Canadian grain exports to the United States, which in turn negatively affected car cycle times.

- In 1993–94 there was an increase in specialty crops. For example, canola production went from 3.6 to 5.4 million tonnes. These grains, according to the Agency, are more difficult to handle and put a heavier demand on the system than standard grains.
- A late harvest in 1993–94 compressed the normal three-month shipping period through Thunder Bay to two months, and a harsh winter hampered railway operations. A work stoppage by west coast longshoremen early in 1994 lasted 13 days and caused additional problems for the system.

6.79 While the above-noted problems were unique to the 1993–94 shipping season, to some extent they served to mask systemic problems that exacerbated the 1993–94 difficulties and have emerged in 1994–95 more clearly: sales peaking and inefficient use of grain cars.

6.80 Demand peaking. As the grain crop is harvested, the shippers and producers are anxious to move the crop to market — both to get a good price and to minimize their carrying costs. This has led to a pattern of increasing demand for cars that peaks in the late fall and early winter of each year. Rising volumes have led to the point when, at times, demand now exceeds capacity. Meeting this demand puts pressure on the system and imposes additional costs on all system participants. The current continent-wide shortage of hoppers, for example, has led to the need to enter into costly long-term leases just to get the car capacity to respond to a very limited demand period of three months,

thereby leaving the railways with excess capacity for the non-peak periods.

6.81 Despite this predictable seasonal pattern, freight rates remain constant throughout the year. Under the *WGTA* regime, the cost to the shipper of shipping grain is the same regardless of when the grain is moved. Accordingly, as there is no incentive to do otherwise, shippers seek to move their grain during the peak period; they are indifferent to the costs that this practice places on the rest of the system. It has been suggested to us by system participants that, were costs to vary with the demand for capacity, the peak period might well spread itself out and enable the current core capacity to handle the crop. The Department of Transport will inherit the *GTA's* car allocation responsibilities under the grain transportation system reform.

6.82 The Department of Transport should study the costs and benefits associated with the way in which the Western Canadian grain transportation system responds to demand peaking.

Department's response: Concur. The Department of Transport will be conducting a policy review of car allocation issues. One of the issues that will be included in the review is demand peaking.

6.83 **Car cycle times — the efficient use of cars.** Car cycle time is a measure used by the industry to indicate how efficiently the hopper car fleet is used. A car cycle is the time a car takes for a round trip — from the time that it is set out for loading at the country elevator, to the time when it is returned for loading again. Over the years, car cycles have averaged about 19 days (see Exhibit 6.10).

6.84 Reductions in car cycle times would benefit the system. In a 1991 discussion paper issued jointly by the departments of Transport and Agriculture and Agri-Food and the Grain Transportation Agency, it was estimated that a reduction in average car cycle times by as little as one day at periods of peak movement would cut grain transportation costs by \$3 million annually. However, because the costs of hopper cars are treated as a part of the overall rate, there is no incentive on the part of users to incur costs to improve efficiency in the use of this resource.

6.85 **Demurrage and storage charges being considered.** Under the *WGTA*, the rate paid by the shipper is unrelated to the length of time that the car is in use for a particular shipment. Because hopper cars are a "free" resource to the companies that use them for carrying their grain, there has been some abuse of them. Very simply, some system participants see loaded cars as a form of free storage, allowing them to avoid or postpone the need to invest in the development or expansion of their port storage facilities. For example, facilities having insufficient storage will unload hopper cars only when enough are at port to fill the needs of a vessel. This can sometimes mean that large numbers of cars will be tied up for significant periods of time with no financial consequences to the shipper. This also makes the cars

Exhibit 6.10

Average Annual Car Cycle Times for Hopper Car Shipments of Grain

	Calendar Year	
	1991	1992
Vancouver	20.9	19.2
Prince Rupert	20.4	19.7
Thunder Bay	17.3	19.6
All Ports	19.6	19.4

Source: Grain Transportation Agency Car Cycle Time Draft Analysis Report on 1991 and 1992 calendar years.

unavailable for loading and congests rail yards.

6.86 Another problem, raised in discussions with system participants, is that even the operators of port terminal elevators with storage capacity may not unload cars holding grains that are not immediately needed. While it is not in the interest of the terminal operators to refuse cars, the fact remains that some commodities are either mis-shipped or are shipped too far in advance of need. In the absence of storage charges or demurrage (a charge for the failure to unload hopper cars with dispatch), neither the operator of the port handling facility nor the shipper is penalized for these or other inefficient uses of resources.

6.87 An analysis of present car cycle times done by the Grain Transportation Agency indicates that roughly eight percent of all hopper cars remain loaded at port longer than five days, and over 10 percent of all car cycles are in excess of 30 days. Obviously, penalties would be a deterrent to inefficient use of hopper cars, and the Senior Grain Transportation Committee recommended the implementation of such sanctions starting in 1989. Previous attempts to establish demurrage or storage charges under the *Western Grain Transportation Act* had been successfully challenged in the courts.

6.88 In order to limit such abuse, the government has directed that the appropriate legal instruments be drafted to implement demurrage and storage charges for hopper cars. We have been advised that revenue received from such charges related to government-owned hopper cars will be returned to the Crown.

6.89 As part of its performance review and capacity planning functions, the Grain Transportation Agency has studied car

cycle times for 1991 and 1992. According to the Agency, because the data were not received on a timely basis, the results of these studies were only released over a year after the operational year in question. These studies require that the railways provide their car movement databases to the Agency and also require significant computer analysis capacity. Prior to these studies, there have been no consistent "third party" analyses of cycle times to provide benchmark figures for industry. However, it should be noted that the Agency has no authority to require the railways to provide these data. The Agency states that it has been unable to obtain data for either the 1993 or the 1994 crop years and, hence, to pursue its objective of more timely ongoing monitoring of cycle times. In the transition period, the Department of Transport will be responsible for the efficient use of the car fleet. This issue will be a very important transition concern. More timely monitoring of these times, perhaps on a monthly basis, could be beneficial in identifying problems and assessing the effect of the government's decision to institute demurrage charges.

6.90 The Department of Transport should, on a timely basis, measure and report on grain hopper car cycle times. In order to effectively monitor system performance, these measurements should include total times and the key components of those times.

Department's response: Concur. As a follow-up to the announcement on WGTA reform, the Department of Transport will be consulting with stakeholders on the data required for ongoing policy assessment and for the two reviews that are planned. Information on car cycle times will be one of the key data requirements.

The National Transportation Agency

Subsidy payments and rate administration appropriately controlled

6.91 The National Transportation Agency establishes the annual rate scale, which is the basis of the payment of the subsidy. The *Western Grain Transportation Act* stipulates that the calculation of this scale is based on eligible railway costs for hauling Western grain, as determined by a quadrennial costing review. This then becomes the cost base that is used to develop rates for the next four crop years. The Agency is also responsible for the payment of the *WGTA* subsidy to the railways. We found that the controls in place for rate administration and subsidy payment systems operated by the National Transportation Agency were appropriate.

Conclusions of reviews not adequately supported

6.92 **The investment review.** The *Western Grain Transportation Act* requires that the railways submit their general investment plans for the movement of grain for the current and the following year. The National Transportation Agency is required to analyze the plans and provide the Minister with an evaluation of the appropriateness of the plans in ensuring “an adequate, reliable and efficient” railway transportation system that will meet future requirements for the movement of grain.

6.93 In its report on railway investment plans for the years 1994 and 1995, the National Transportation Agency identified adequacy, reliability and efficiency of the railway transportation system as the three criteria against which the investment plans were to be assessed. It argued that

assessment against these criteria requires that benchmarks be used; however, it also indicated that this is not feasible and that trying to satisfy each criterion independently would violate the efficiency criterion. The Agency further argues that to improve efficiency, the investment plans would have to demonstrate that the adequacy and reliability criteria have been optimized simultaneously.

6.94 As the National Transportation Agency believed that a quantitative analysis was not feasible, it assessed these criteria qualitatively. According to the Agency, this was done by looking at the positive impact of each investment proposal. In assessing the effect of an expenditure on system efficiency, the Agency stated that it could draw on its knowledge and judgment, albeit subjective in the final analysis, gleaned from its ongoing oversight of the industry and its intensive involvement in *WGTA* and railway monitoring programs. Ultimately, the Agency concluded that, in its opinion, the investment plans were appropriate and so reported. The quality of the Agency’s documentation of its qualitative analysis of the effect of investments on an adequate, reliable and efficient grain transportation system was such that we were not able to conclude as to whether or not the Agency’s opinion was warranted and should be relied on by the Minister.

6.95 **The quadrennial review.** The *WGTA* also requires the National Transportation Agency to conduct a quadrennial review of the costs incurred by the railways in moving Western grain. The most recent review was completed in 1994 and examined the railway’s costs for the 1992 crop year. In performing the quadrennial costing review, the Agency is directed by the Act to complete a review and to determine, for the year under review, the costs of moving grain and the

costs of grain-dependent branch lines. In doing this, the Agency is directed to take into account all costs:

- actually incurred;
- directly related to an adequate, reliable and efficient railway system; and
- that will meet future requirements for the movement of grain.

6.96 This means that the National Transportation Agency must assess each cost element submitted by the railways against the three standards established in the legislation. If the cost passes all three standards, then it must be included in the overall cost base. However, if the cost fails any of these tests, then it may be excluded from the base by the Agency.

6.97 We reviewed the National Transportation Agency's conduct of the 1994 quadrennial review and concluded that, in conducting the review, the Agency had addressed the first standard and had reasonable evidence that the claimed costs were actually incurred. We also found that it had, as required, adjusted historic railway costs for any efficiency gains that were known and measurable, thereby showing that it had assessed certain costs against the third standard. However, in examining the working papers for the review, we were unable to determine how the Agency had determined whether there was a link between the costs incurred by the railways and an adequate, reliable and efficient railway transportation system for Western grain. While the extensive working papers for the review contained a great deal of detailed information on how the Agency assessed the costs submitted to it by the railways, with respect to the standards of occurrence and future contribution, the Agency could not provide similar working papers showing that these costs had systematically been assessed with respect

to their relation to an adequate, reliable and efficient railway system. The Agency informs us, however, that while it did not document this aspect of its analysis, the assessment of these costs for their contribution to an adequate, reliable and efficient system was carried out by its analysts, who assessed this concern in the course of their work, based on their experience in railway matters.

6.98 In reviewing the Agency's report on the quadrennial costing review, we noted that it would have been clearer for the reader if the Agency had explained its approach to the assessment of the direct contribution of costs to an adequate, reliable and efficient system as fully as it disclosed its approach to the assessment of whether the costs were actually incurred and whether the costs contributed to future requirements for the movement of grain.

6.99 In neither instance has the National Transportation Agency fully defined what would constitute an adequate, reliable and efficient railway transportation system for the movement of grain. Without such a definition, the Agency is not in a position to conclude, as it has, that costs and investments are made in support of such a system. The Agency argues that it has had extensive consultations with the system participants, maintains extensive data on the operations of the railways in the grain transportation system, and combines this information in its qualitative assessment of the system. The Agency has stated that it firmly believes that to quantitatively assess the "adequacy, reliability and efficiency" of the system through operationalizing these terms or developing strict benchmarking assessment criteria is tantamount to second-guessing railway management decisions, which is not the role of the transport regulator in the 1990s.

We were unable to determine how the Agency had determined whether there was a link between the costs incurred by the railways and an adequate, reliable and efficient railway transportation system for Western grain.

Proposed Reforms

Subsidy to be eliminated

6.100 The recent federal Budget announced plans to eliminate the subsidy under the *WGTA* effective 1 August 1995. The effects of this change include:

- shippers will pay the full rate, which will be nearly double the amount that they currently pay. In this circumstance, it is likely that shippers and producers will expect higher levels of service and system performance in return;
- removal of the incentive for backtracking. Backtracking involves the movement of grain from Western Canada to Thunder Bay and then back westward for ultimate shipment to the United States. The practice occurs because movements are subsidized from origin to Thunder Bay. The elimination of the subsidy should put an end to these grain movements that waste resources through circuitous routings.

Abandonment prohibition orders will be lifted

6.101 Since 1985, government orders have prohibited any abandonment of grain-dependent branch lines. While abandonments can still occur under this prohibition, they require approval of the Governor in Council, in addition to the normal abandonment approval from the National Transportation Agency. Of the 6,988 miles of branch lines that were in place in 1985–86, only 886 miles, or 13 percent, have been abandoned since. The government proposes lifting abandonment protection on all branch lines effective 31 December 1995. As well, it plans to decrease freight rates based on a deemed railway saving of \$10,000 per mile of abandoned track, although actual savings to the railways will likely be higher.

6.102 In 1986, the federal government established a Systems Improvement Reserve (SIR), which is managed by the Grain Transportation Agency to provide lower-cost alternatives to producers whose high-cost branch lines were being closed. The programs being funded have resulted in annual savings of \$7.4 million and the abandonment of 470 miles of track, or more than 50 percent of all abandonments since 1986. While the program has had some success, it has been limited by the lack of additional funds. The government may continue the program under the *WGTA* Adjustment Fund.

Deregulation of freight rates to be phased in

6.103 The government plans to have the shipper-oriented provisions of the *National Transportation Act* apply to movements now made under the *WGTA*, effective 1 August 1995. The rate will be legislated for a five-year transition period, after which the rate will be deregulated. Under the *WGTA* regime, the railways could not always reasonably anticipate that all of the leasing costs that they would incur in acquiring surge capacity would be returned to them in the form of higher rates resulting from the next costing review. Following the events of 1993–94, the Grain Transportation Agency recommended that the Act be changed such that, in these circumstances, an annual adjustment could be made to the base rate to reflect the costs to the railways of making leasing arrangements to respond to peak demands. Under the proposed legislation for system reform, the railways will no longer be able to anticipate recovering these additional costs. This may well make them more reluctant to incur such costs, when faced with potentially expensive requests to respond to peak demands.

Potential change in ownership of the hopper car fleet

6.104 The Department of Transport has proposed that the sale or lease of the federal hopper car fleet be considered. Such a move would mean that the ownership costs of the fleet would be included in railway costs for calculating freight rates, rather than being provided free of charge, as is the case now. The change in ownership may affect the car allocation function currently carried out by the government. The government has stated that it will retain its hopper car fleet for now, but will complete, by the end of this year, a review of this issue, as well as the matters of car allocation and the role of the Canadian Wheat Board as it relates to grain transportation.

Reviews of the program

6.105 Many studies of different aspects of the *Western Grain Transportation Act* have been carried out by many different groups, but no program evaluation of the effectiveness of the Act has ever been conducted. The Department considered such an evaluation in 1988, but decided not to proceed as it had been made aware that the federal government was beginning a comprehensive review of all agricultural programs under the direction of the Minister of Agriculture and intended to include the grain transportation system in the review.

6.106 The government proposes to have an industry-led assessment of performance undertaken prior to the 1998–99 crop year, the results of which are to be reported to the Ministers of Transport and of Agriculture and Agri-Food. The review is to examine revenues and cost performance in the system and report on the degree to which efficiency gains have been achieved and shared.

6.107 A statutory review is to be completed in 1999 to examine the overall effectiveness of rate regulation and the *National Transportation Act* provisions in improving the efficiency of the grain transportation and handling system. If this review is to be properly carried out, it will require considerable planning and resources. Because the purpose of the review is to measure change, the data for many of the key measurements will need to be captured soon. This will mean that the Department will need to act quickly to address such questions as, What are the measures that define an efficient and effective grain transportation system? How will efficiency changes be identified and quantified?

6.108 Our review of the quadrennial costing review suggests that gathering, assessing and analyzing such data is complex and requires both resources and expertise. Some of those data and the required expertise to assess and analyze them are currently at the National Transportation Agency. It will be important to ensure that the necessary expertise continues to be available to maintain the data and to carry out the review in 1999. Finally, it should be noted that much of the information necessary for the review will have to come from private corporations. Under the current program, some of these corporations are required by law to provide some of the necessary information to the National Transportation Agency. The termination of the program will also end that obligation. Without a continuation of this requirement, it is likely that the completeness and objectivity of information from these sources could be compromised.

6.109 The Department of Transport and the National Transportation Agency should take steps now to ensure that the government has the information,

expertise and resources necessary to carry out any work it will be responsible for under the 1998 industry-led review and the 1999 government review announced in the Budget.

***Joint TC/NTA response:** The two organizations agree with the recommendation and will work co-operatively on the matter to ensure appropriate information, expertise and resources are available for the reviews.*

Part III: The Atlantic Region Freight Assistance Program

Introduction

6.110 This section of our audit focusses on the Atlantic Region Freight Assistance Program (ARFA). This program is also known as ARFAA/MFRA — based on the names of the two Acts under which it operates: the *Atlantic Region Freight Assistance Act* and the *Maritime Freight Rates Act*. To minimize confusion, we have used the collective term ‘ARFA’ for general references to the program and have restricted references to the Acts to specific discussions of them.

The origins of ARFA

6.111 The origins of ARFA derive from the decision made by the Dominion government to have an all-Canadian route for the Intercolonial Railway, which was completed in 1876. This railway ran from Halifax to Rivière-du-Loup and connected there to the Grand Trunk line to Montreal and the rest of central Canada. This decision resulted in a route 250 miles

longer than the shortest possible route through the United States.

6.112 The *Maritime Freight Rates Act* was passed in 1927. This Act provided for a 20 percent subsidy on “preferred” movements, which were defined as: local rail traffic between points in the Select Territory (the Maritime provinces and the Canadian National lines through the Province of Quebec to near Lévis); and traffic westbound from the Select Territory to the rest of Canada.

6.113 The preamble of the Act presented the logic for the program as follows:

... the Intercolonial Railway was designed, among other things, to give Canada in times of national and Imperial need an outlet and inlet on the Atlantic Ocean, and to afford to Maritime merchants, traders, and manufacturers the larger market of the whole Canadian people instead of the restricted market of the Maritimes themselves, also that strategic considerations determined a longer route than was actually necessary, and therefore that to the extent that commercial considerations were subordinated to national, imperial and strategic conditions, the cost of the railway should be borne by the

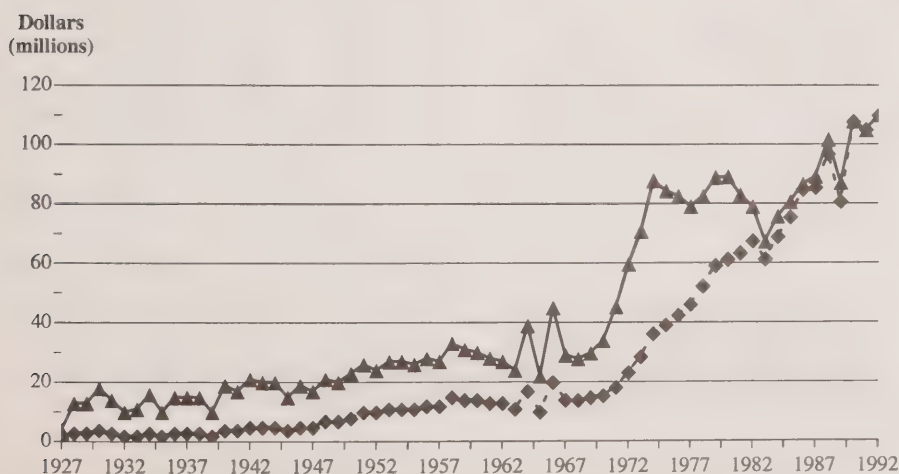


Exhibit 6.11

Atlantic Region Freight Rate Subsidies in Current and Constant (1992) Dollars (1927 to 1992)

—▲— Constant Dollars
--◆-- Current Dollars

Source: Department of Transport, Information Paper (1994:42)

Dominion, and not by the traffic which might pass over the line.

6.114 From 1926 until 1969 the program functioned as a subsidy to two classes of rail freight: traffic westbound from the Select Territory and movements within the Territory. Expenditure growth during that period was steady but modest in terms of both current and constant dollars, as can be seen in Exhibit 6.11.

6.115 In 1969 the program expanded to provide for payment of the subsidy for movements by truck both westbound from and within the Select Territory. The result was a significant change in the rate of growth of program expenditures (see Exhibit 6.11). Trucking very rapidly became the dominant recipient of the subsidies.

6.116 The last significant change in the program was the introduction of a Selective Westbound subsidy in 1974. This subsidy, paid on top of the Basic Westbound subsidy, was to be paid only on products deemed to have achieved some value-added within the territory.

6.117 The current program exists in a form virtually unchanged from that time. There are three major subprograms to the program: the Basic Westbound — paid on effectively all movements westward from the Select Territory; the Selective Westbound — paid on westbound movements of commodities that have been grown, harvested or manufactured in the Territory, and the Intra-regional — paid on all movements within the Select Territory of a wide range of goods, provided those goods were also grown, harvested or manufactured within the Territory. In each subprogram, the subsidy is paid as a

Exhibit 6.12

ARFA Program Subsidy
Payments by Subprogram
and by Mode (1981 and 1992)

	1981		1992	
	\$ millions	%	\$ millions	%
Intra-regional				
Truck	32.4	81	47.5	82
Rail	7.1	18	9.6	17
Marine	0.3	1	0.7	1
Total	39.8	60	57.8	53
Basic Westbound				
Truck	11.6	55	28.8	75
Rail	9.4	45	9.6	25
Total	21	31	38.4	35
Select Westbound				
Truck	3.1	50	10.1	73
Rail	3.1	50	3.7	27
Total	6.2	9	13.8	12
TOTAL	67	100	110	100

Source: Department of Transport,
Information Paper (1994:55)

Note: The 1981 figures are unaudited. The 1992 trucking figures are derived from the Department of Transport database that we have reviewed.

percentage of the freight charges for the eligible movement. For the Basic Westbound, the maximum subsidy rate is 28.5 percent, and for the Selective Westbound the maximum is 20 percent. The result is a combined maximum rate of 48.5 percent for movements eligible for both subsidies. The rate actually paid on westbound movements is proportional to the percentage of the movement that took place within the Select Territory. The rate for the Intra-regional subprogram is eight percent of the freight charge.

6.118 According to the Agency, in 1994–95 it had 42 people working on the delivery of the program and a program delivery cost of approximately \$2 million. Each year the Agency processes about 20,000 claims covering approximately two million movements.

6.119 Exhibit 6.12 presents a breakdown of program expenditures by subprogram and by mode for the years 1981 and 1992. The Intra-regional component was and is the dominant component of the program, with 60 percent of expenditures in 1981 and 53 percent in 1992. Within the Intra-regional, trucking is the dominant mode, receiving just over 80 percent of payments in both years. The other major feature of the table is the decline of rail in the westbound traffic over the decade. Rail had roughly half the subsidy payments for both the Basic and Selective programs in 1981 and has now slipped to just over one quarter of the westbound payments.

Objectives and Scope

6.120 While the ultimate responsibility for the program lies with the Minister of Transport, management of the program is split between the Department of Transport, which has policy responsibility for the program, and the National Transportation Agency, which is responsible for the

administration of the program including the payment of the subsidies. This split in accountability is tempered by the fact that when the National Transportation Agency identifies an administrative problem in the program that requires a change in the regulations to fix, it must bring the matter to the attention of the Department of Transport, which in turn is responsible for acting to bring about the necessary change.

6.121 Program management is responsible for ensuring that it has procedures to measure and report on the effectiveness of the program. This responsibility for ARFA lies with the Department of Transport. The Department had completed a study entitled *Atlantic Region Freight Assistance Program, Information Paper*. We reviewed this study to determine whether it satisfactorily measured and reported on the effectiveness of the program.

6.122 We assessed the controls that the Agency had in place to ensure that payments were made only for movements that were eligible for subsidy, and to ensure that payments for movements were made in the correct amount. The Agency has two units that are intended to serve as management's control for determining eligibility and payment amount. There is a desk audit section that reviews a selection of claims before payment. It is intended to be a check on matters such as clerical errors in claims, and the eligibility of commodities and of movements. As well, there is a field audit section that conducts follow-up audits of the claims made by specific carriers after the payments have been made.

6.123 We examined the operations of these units to determine the degree to which they provided management with reasonable assurance that program delivery risks were being controlled. However, in light of the decision of the government,

announced in the Budget of 27 February 1995, to terminate the program on 1 July 1995, we have concluded that our findings focussing largely on administrative matters are no longer of a nature and significance to be reported to Parliament. In addition, there would now be little value in making recommendations that could not be implemented before the end of the program. We have drawn to the Agency's attention, by way of a management letter, the results of this audit work.

6.124 We decided to report our conclusions on the Department of Transport's *Information Paper* and on some weaknesses in the program delivery because we believe they will assist Parliament in dealing with the legislative implications of the Budget announcement, and in drawing attention to the need for control in the wind-up of the program.

Observations and Recommendations

Effectiveness Measurement

6.125 When we audited the Atlantic Region Freight Assistance Program in 1987, we recommended that it be evaluated. This recommendation was reinforced by a more general recommendation, made by the National Transportation Act Review Commission in 1993, to evaluate all the subsidy programs. In 1993 the Department of Transport began an evaluation of ARFA to assess the current effectiveness of the program, to provide for information on the effects of cuts to the program announced in the 1992 Budget, and to provide a common base of information and understanding about the program. The study was completed in July 1994 and the report entitled *Atlantic Region Freight Assistance Program, Information Paper* has received wide

distribution among the public, and to members of Parliament.

6.126 One of the important features of the *Information Paper* is the database on the program created by the study team. While the National Transportation Agency maintains records of all claims, only payment information is maintained in electronic format. To obtain the information needed to measure program effects, the study team took a sample of nearly 75,000 movements from the approximately 2 million movements that were subsidized in 1992. The Department, assisted by the National Transportation Agency, entered the key information relating to these movements into a database. This database was central to some of the analyses done for the *Information Paper*.

6.127 As part of our examination of the *Information Paper*, we reviewed the database both to assure ourselves about its contribution to the findings of the study and to determine whether we could rely on certain of the data to support audit-related analysis. Our review was restricted to testing the database entries against the original shipping documents on file with the National Transportation Agency, and reviewing and discussing with members of the study team their quality control procedures. In planning our work, and in evaluating the results of our testing, we were seeking assurance that the cumulative effect of detected errors would not materially affect the findings of the report.

6.128 During the audit, the National Transportation Agency advised us that inquiries it had made had led it to the conclusion that, among other things, in certain instances the distances recorded in the database for certain types of movements were in error. We have examined a sample of the records and have found this to be so for certain types of

movements. As a result, based on additional information provided by the National Transportation Agency, we extended our testing and have concluded that while the errors might affect certain applications of the data, their effect on the main finding, the percentage of payments in the Intra-regional subprogram made to movements under 200 kilometres, was not material in the decision-making context for which the study was intended.

6.129 As the *Information Paper* notes, "... the objective of the Atlantic freight subsidy program is obscure after so many intervening years and program amendments." The objective stated in the original 1927 Act — the *Maritime Freight Rates Act* — was "... to give certain statutory advantages in rates to persons and industries in the three provinces of New Brunswick, Nova Scotia and Prince Edward Island, and in addition on the [railway] lines in the province of Quebec ..." Reading this section together with the preamble to the Act suggests that the desire to provide an advantage was in response to a demand by Maritimers to compensate the users of the Intercolonial Railway for the additional costs imposed by an all-Canadian route and thus to encourage the movement of Maritime goods to central Canada. In this context, it is worth noting that the *Information Paper* found that in the Westbound subprograms, nearly 60 percent of the trucking tonnage originated and terminated within 400 kilometres of the Territory boundary.

6.130 Some of the other key findings of the *Information Paper* include:

- a) The cost of transportation in relation to the total output value of the goods producing sector in Canada continues to decline. Between 1961 and 1989, the transport cost for the manufacturing sector dropped by over 30 percent. This in turn reduces the

importance of the subsidy in stimulating regional economic growth.

- b) Atlantic producers have a low and decreasing dependence on Central Canada markets. Indeed, the share of Central and Western Canadian markets for these producers declined from 21 percent to 16 percent between 1967 and 1992, whereas export markets rose from 26 percent to 43 percent. The importance of domestic shipments within the Atlantic region has also fallen (from 53 percent in 1967 to 42 percent in 1992).

- c) Producers in Eastern Quebec account for a large and increasing share of the subsidy payments paid for Westbound movements by truck. The majority of these subsidized movements are destined for other parts of Quebec. Many consignees are located within a short distance of the boundary.

- d) Although the raw material producing sector exhibits a relatively high subsidy sensitivity, it represents rather minor significance to the overall Atlantic economy.

6.131 We reviewed the significant findings of the *Information Paper* in relation to the standards established by the Treasury Board and our Office's criteria for the conduct of sound and reliable effectiveness studies. For the major areas addressed by the *Information Paper*, we reviewed the reliability and suitability of the data employed, traced many of the specific quantitative findings back to the original data, and assessed the appropriateness of the methodologies employed and the reasonableness of the findings reached.

6.132 We found that the *Information Paper* was done with care, and that management used both internal challenge

and discussion as well as a peer review to achieve assurance as to the reliability and objectivity of the study. Management also sought and received the assurance of Statistics Canada on the suitability and soundness of the sampling procedures used in developing the database. Where extensive use was made of the Statistics Canada Trucking Origin/Destination Survey database, the Department had Statistics Canada's experts review the analysis.

6.133 Based on our review of the *Information Paper*, we have concluded that, within the inherent limitations of such studies, the *Atlantic Region Freight Assistance Program, Information Paper* is a sound and reliable study. Indeed, although the *Information Paper* was conducted outside the formal government "program evaluation" framework, in many ways it represents a very good example of what a program evaluation can be and what it can contribute to decision making.

Program Control

Non-arm's length transactions and freight rates

6.134 Background. When we audited this program in 1987, we expressed concerns about the eligibility of carriers for subsidies under the Intra-regional subprogram in situations where the carrier and the shipper of the goods are in a non-arm's length relationship. We found that this matter continues to be a concern.

6.135 Only the Intra-regional regulations forbid the subsidization of a carrier for the movement of goods belonging to it or to those who own or control it (Section 2(2)(h) of the Atlantic Region Special Selective Subsidy Program Assistance Regulations). The other subprograms do not contain a similar provision.

6.136 There are two approaches used in assessing the relationship between a shipper and a carrier: *de jure* and *de facto* control. *De jure* control is determined based on an examination of the legal form of ownership between the two firms. For example, if a husband and wife together owned 100 percent of both the shipper and carrier, but the husband owned 51 percent of the one and the wife owned 51 percent of the other, then a strict *de jure* determination would conclude that the two companies were not affiliated. The determination of *de facto* control looks beyond the legal form of the relationship and examines the substance of day-to-day operations and control. Such an examination would consider matters such as: Do the shipper and carrier maintain separate offices, telephones, accounting records, and bank accounts? Does one person seem to be giving all or most of the direction to both enterprises? Are the assets of the enterprises clearly segregated?

6.137 In early 1984, the Canadian Transportation Commission (the predecessor of the National Transportation Agency) denied subsidy payments to a carrier because it believed that it was affiliated with the relevant shipper and therefore that those movements were contrary to Section 2(2)(h). The carrier appealed and the court overruled the Commission's decision. In making its decision, the court relied on the *de jure* relationship between the shipper and carrier.

6.138 Later in 1984, the Commission informed the Minister of Transport of the possible effect of the court decisions on the original intent of the Intra-regional subprogram, and suggested amending the regulations to tighten the wording and further clarify the original intent. A year later, in 1985, the Commission again wrote to the Minister of Transport setting out the

problem and requesting action on a solution. The regulation remained unchanged for eight years after that, and the matter was not pursued further.

6.139 Deregulation. By 1988 the regulation of motor carriers by the provinces in the Select Territory no longer included the regulation of rates. This meant that rates were and are now uncontrolled except by the discipline of the market. Insofar as the relationship between shipper and carrier is an arm's length market relationship, there is reason to believe that this will lead to fair and reasonable rates. However, with the deregulation of rates, the situation changed significantly in cases where a non-arm's length relationship existed between the shipper and carrier. In such instances, the relationship is not one of the normal market — prices charged by one to the other could be simply "paper" entries or transfer prices that disappear on consolidation of the accounts — and the rates charged by the former to the latter are not subjected to the discipline of the market. Because the subsidy amounts are directly proportional to the rates charged, the program has built into it a potential incentive to inflate rates to maximize the subsidy receivable.

6.140 This issue was explored in the Transport Canada *Information Paper* in an

analysis that compared the revenues per tonne-kilometre received respectively by non-integrated (arm's length) and vertically integrated (non-arm's length) shipper-carrier relationships. The *Information Paper* findings indicated that the revenue per tonne-kilometre of certain integrated carriers was significantly higher, statistically, than that of their non-integrated counterparts. Because of these findings, our earlier (1987) concerns and the potential impact of this matter on payments under the program, we pursued the issue further.

Growth in the subsidization of the non-arm's length market

6.141 We reviewed the files of all carriers who received over \$100,000 in subsidy payments in 1992 and, in consultation with National Transportation Agency officials, identified all carriers operating in a non-arm's length relationship with one or more shippers. Using the Department of Transport's database on the 1992 ARFAA Subsidy Payments (1992 DOT database), we identified the non-arm's length business segment of these carriers. We found that this segment has increased significantly over the past 10 years.

6.142 Exhibit 6.13 shows the total non-arm's length business of large carriers

With the deregulation of rates, the situation changed significantly in cases where a non-arm's length relationship existed between the shipper and carrier.

Percentage of
Total Subsidy Paid



Exhibit 6.13

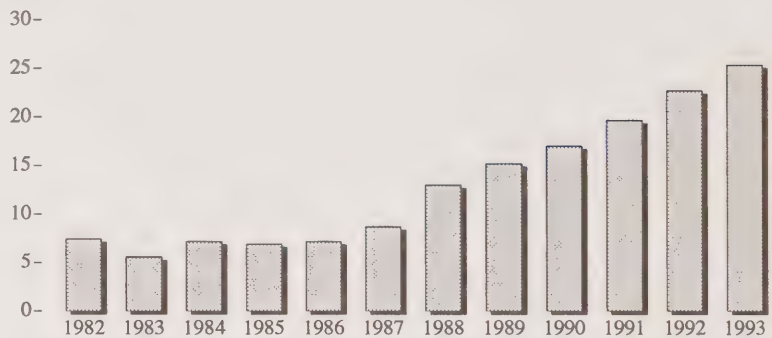
The Proportion of Total Subsidy Payments to Truck Carriers Paid to Larger Carriers with Respect to Their Non-arm's Length Business 1982 to 1993

Source: Information from the National Transportation Agency, and the 1992 Department of Transport database on ARFA

Exhibit 6.14

The Proportion of Total Subsidy Payments to Truck Carriers Paid to Larger Carriers Doing Business Almost Exclusively on a Non-arm's Length Basis (1982 to 1993)

Percentage of Total Subsidy Paid



Source: Information from the National Transportation Agency and the 1992 Department of Transport database on ARFA

as a proportion of the total subsidies paid to carriers for the years 1982 to 1993.

6.143 Exhibit 6.14 shows the portion of the subsidies paid to carriers doing business almost exclusively on the non-arm's length market as a proportion of total subsidies paid to trucking companies.

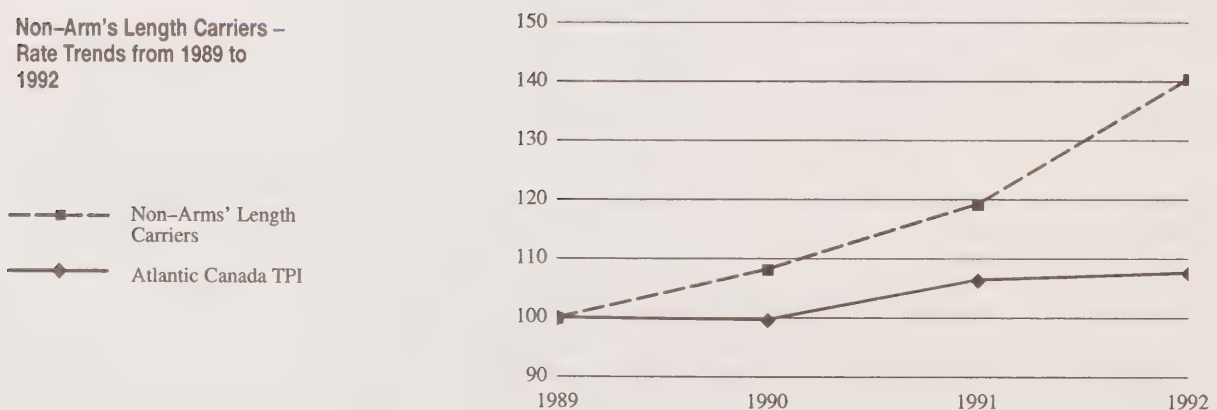
6.144 To complete our analysis of non-arm's length freight rates, we returned to our sample of non-arm's length carriers that had received more than \$100,000 in subsidy payments in 1992. For a number of carriers, we reviewed a sample of its

related-business tariffs filed with the National Transportation Agency and recorded the trend. As a result of our analysis, we concluded that, in some cases, freight rates established on the non-arm's length market are growing at a pace significantly greater than the Atlantic Trucking Price Index, an index that measures the overall change from year to year in the price of trucking in Atlantic Canada. Exhibit 6.15 shows a composite tariff index for certain non-arm's length carriers compared to the Atlantic Trucking Price Index.

Exhibit 6.15

Non-Arm's Length Carriers – Rate Trends from 1989 to 1992

Price Index



Source: National Transportation Agency files

Note: Rates and indexes indexed to 1989 = 100

6.145 Overall, our analysis of the above findings, the design of the program and other information has led us to conclude that the risk is significant that some carriers in the non-arm's length market are setting their rates to maximize the subsidy payable to them. The steadily growing proportion of the subsidy being paid to non-arm's length shipper-carriers, when combined with the effects of the deregulation of freight charges throughout the Select Territory, has resulted in a program, designed for another era, that has become increasingly ill-suited to the current state of the industry that it is subsidizing.

Assessment of affiliation in the Intra-regional subprogram

6.146 We reviewed the controls that the National Transportation Agency had in place to respond to this risk. In the case of the Intra-regional subprogram, which has a provision limiting access to the program for movements involving non-arm's length shipper-carriers, we would have expected the Agency to have in place systematic procedures to ensure that such relationships were identified and ineligible movements arising from them were excluded from the program. We noted that, as discussed in paragraphs 6.137 and 6.138, the Agency had made earlier attempts to enforce this provision and had been rebuffed by the courts.

6.147 According to the Agency, it takes several steps to control access. It states that in the carrier certification process it has procedures that are intended to identify potential non-arm's length relationships and to warn the carrier about them. It has also prepared a guide to the program, which is issued to applicants. However, when we examined the actions of the Agency's Field Audit unit, which is the Agency's key control in attempting to limit access to the program for movements

involving non-arm's length shipper-carriers, we found that the emphasis was on assessing control on a *de jure* basis. The Agency had developed guidelines on the assessment of control. These guidelines, issued to the Agency's Field Audit unit in late 1991, included directions on factors to consider in establishing *de facto* control. The Agency has provided us with three examples in which it has used these guidelines to assess possible instances of *de facto* control. The Agency's approach is generally focussed on assessing *de jure* control based only on an examination of the ownership structure of the carrier.

No limit on subsidized rates

6.148 The regulations for the Intra-regional and Selective Westbound subprograms state that a movement may be subsidized only when the carrier has filed with the Agency a tariff satisfactory to the Agency. (The key words in French are "... a déposé auprès de la Commission un tarif jugé satisfaisant par elle....") Prior to deregulation in the late 1980s, provincial regulatory bodies in the Select Territory controlled most tariffs filed with the Agency. This meant that, for most movements, the filing of rates by the Agency was largely a formalized exercise. We have been informed by the Agency that, during this period, the Agency assessed the reasonableness of the rates filed with it for those segments of the trucking market that were unregulated.

6.149 The amount of the subsidy paid is directly determined by the rate charged for the subsidized movement. We would have expected that the Agency would have looked at the reasonableness of the rates being filed with it as part of claims, simply as a way of detecting possible clerical errors on the part of filers. However, in light of the risks to the program posed by

the combination of limited control on access to the program by non-arm's length carriers and deregulation of rates, we would have expected that the authority for the program would have provided the Agency with a clear mandate to review rates submitted to it for subsidy. We would also have expected it to have carefully scrutinized the rates presented to it in carriers' claims.

6.150 We observed that the Agency does not conduct any systematic assessment of the freight rates filed with it or of the rates filed with each movement as part of a claim for subsidy. In discussions with Agency officials, we have been told that, over the years, when claims showing unusually high rates have been submitted, inquiries to the claimant made by the Agency have resulted in revised and more reasonable claims. The Agency has provided documentation on one instance.

The Agency states: The Agency does not have the authority to control rates. Accordingly, Agency policy is to pay the subsidy based on the freight charges for eligible movements and commodities reported by the carrier in its claim.

6.151 With respect to the requirement that a tariff satisfactory to the Agency be filed before a claim may be paid, the Agency has asserted that this wording applies only to the form and not the content of the filed information. If this reading of the regulations is correct (the Agency has never attempted to test it in the courts), then in our view, in light of the risks to the public purse involved, we would have expected the Agency to have urgently sought the regulatory or legislative changes needed to enable it to control the problem. Instead, the Agency asked that the Department of Transport amend the regulations to eliminate the carriers' current obligation to file a rate when making a claim. The request was approved

by the Department in 1989. Processing was lengthy. The final document was forwarded to the Department for approval on 3 November 1994 but was not processed, as program changes were pending.

6.152 As discussed in paragraph 6.138, the Agency was not unaware of the risks, and had recommended changes to the regulations. Additionally, in the spring of 1992, the Atlantic Regional Office of the Agency conducted a study in response to a television program. The program claimed that certain large carriers were charging their parent carrier more for their affiliated westbound traffic than they were charging to make similar movements for non-affiliated shippers. It was also alleged that these carriers were using the larger subsidy to undercut other independent carriers. The study was ultimately unable "... to come to a definitive conclusion that the larger carriers have 'artificially inflated' their rates for shippers with which they are affiliated." It did, however, identify one case where a shipper was paying its affiliated carrier 200 percent more than its non-affiliated carriers to ship the same commodities. The study concluded:

It would appear that three of these trucking companies ... have been established for the sole purpose of freight assistance entitlement under the ARFAP.... To the extent that the Agency has no jurisdiction in controlling rates, some of these carriers appear to be taking advantage of this loophole and appear to be abusing the program. Whether this perceived abuse amounts to an intent to defraud the Federal Government is a matter to be decided by Legal Services after further investigations.

Based on the information we have seen, the Agency's Legal Services have never been

asked to provide advice on the specific facts related to these three carriers. The Agency did meet with representatives of two of the carriers and had prior knowledge of the third. The Agency concluded that it was satisfied by their explanations of the rates, and hence had no need of advice from Legal Services.

6.153 While the Agency conducted some limited follow-up on this study, it did not extend its effort to examine further the rates being submitted to it. The rate study was completed in the summer of 1992, and the Agency terminated follow-up on the study in January 1993, at the same time as the Department of Transport began its study of the program. The rate study was sent to the Department of Transport in 1994.

Inadequate documentation

6.154 The regulations governing the subprograms are quite explicit in describing the documents that the Agency must receive from the claimant before the Agency is permitted to pay the subsidy. These documents must be submitted along with a summary of the claim and a statutory declaration. The regulations include a requirement that the claimant submit copies of "... all bills of lading, probills or waybills ..." related to each movement to be subsidized. According to the regulations, the Agency may require other documents, which it does, in some cases, by requiring the carrier to submit proof that it was paid by the shipper for the movement.

6.155 These documents are important because they represent the proof the Agency receives that the carrier is entitled to the subsidy payment. When the required documents are not submitted or are submitted in an incomplete and unsatisfactory state, it is very difficult for the Agency to make a proper assessment of

the claim. However, we observed that claims were often paid when the required evidence had not been fully provided in the claim.

Recommendations

6.156 The Atlantic Region Freight Assistance Program will end 1 July 1995. The special risks inherent in a wind-up situation must be addressed.

6.157 The National Transportation Agency should, based on a risk assessment, compare all claims identified by the risk assessment for movements from January 1995 to the end of the program with the claimants' previous claims to assess their reasonableness. Increases in either levels of activity or rates should be thoroughly investigated before the claim is paid.

Agency's response: Agree. The Agency initiated the risk assessment as soon as the Auditor General's recommendation was finalized. The results of this risk assessment are now being used to identify claims showing significant increases in the levels of activity or rates. Once action with respect to the second recommendation is known, the Agency will proceed to finalize processing of claims.

6.158 As discussed above, The National Transportation Agency believes that under the current regulations for the program it lacks the authority to question the reasonableness of the freight charges submitted to it for subsidy payment.

6.159 The National Transportation Agency should request the Department of Transport to seek for the Agency a clear authority to reject claims where it is unable to satisfy itself as to the reasonableness of the freight charges submitted to it.

Agency's response: Agree. As stated in the Auditor General's Report, the NTA does

not believe that it has, at present, the jurisdiction to reject payment solely on the basis of the level of rates contained within a claim. The Agency has written to the

Department of Transport requesting that the Agency be given clear instructions and authority with respect to rejecting "unreasonable" freight charges.

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For further information, please contact Hugh McRoberts, the responsible auditor.

Appendix

The following tables display direct and indirect transportation subsidy expenditures for the years 1988–89 to 1994–95. The figures for 1988–89 to 1992–93 are actual figures and the figures for 1993–94 and 1994–95 are estimates. The indirect subsidy data are taken from figures that originate with the Department of Transport – Cost Recovery Branch. The direct subsidy data are taken from the Public Accounts and the Estimates. The second table has been adjusted for changes in the Consumer Price Index.

Exhibit 6A.1
Details on Direct and Indirect Federal Transportation Subsidies for 1988–89 to 1994–95
\$ Millions per Fiscal Year

	1988–89 Actual	1989–90 Actual	1990–91 Actual	1991–92 Actual	1992–93 Actual	Five Year	1993–94 Estimate	1994–95 Estimate
DIRECT SUBSIDIES								
Western Grain Transportation Act	\$ 777.3	\$ 568.8	\$ 644.9	\$ 1,049.1	\$ 722.7	\$ 3,762.8	\$ 726.5	\$ 650.0
VIA	607.4	521.1	441.5	435.0	366.3	2,371.3	343.4	330.9
Branch Lines Uneconomic	17.7	18.3	21.0	27.6	22.3	106.9	16.7	25.8
Lease of grain cars	15.3	14.9	15.1	14.9	15.0	75.2	14.0	15.5
Rail Crossing And Relocation	14.3	16.1	16.0	11.3	7.6	65.3	9.0	15.0
Atlantic Region Freight Assistance Act – rail	9.0	10.9	11.2	13.0	11.0	55.1	14.2	13.4
Maritime Freight Rate Act	12.9	11.0	10.7	8.9	10.9	54.4	9.7	9.1
Passenger Services	8.4	6.5	5.2	16.7	11.5	48.3	9.2	9.0
Strategic Capital Investments/Initiatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.5
Grain Subsidy	45.4	8.2	0.0	0.0	0.0	53.6	0.0	0.0
Branchline Rehabilitation	28.6	5.5	0.0	0.0	0.0	34.1	0.0	0.0
Branch Lines Unprotected	3.7	0.2	3.2	0.0	0.0	7.1	0.0	0.0
Branch Lines Protected	3.9	0.4	11.5	0.0	0.0	15.8	0.0	0.0
At&East	40.4	25.2	0.0	0.0	0.0	65.6	0.0	0.0
Railway Relocation	3.0	0.0	0.0	0.0	0.0	3.0	0.0	0.0
Montreal commuter trains	8.0	0.0	0.0	0.0	0.0	8.0	0.0	0.0
Other	7.8	0.0	0.0	35.5	0.5	43.8	4.0	0.0
Subtotal Rail	\$ 1,603.1	\$ 1,207.1	\$ 1,180.3	\$ 1,612.0	\$ 1,167.8	\$ 6,770.3	\$ 1,146.7	\$ 1,073.2
Marine Atlantic	135.3	268.8	143.9	127.2	131.3	806.5	132.4	127.7
Jacques Cartier Champlain Bridge Incorporated	8.8	13.9	27.9	26.4	31.5	108.5	36.8	37.0
BC ferry	16.4	17.0	17.8	18.8	19.6	89.6	18.4	19.0
Other ferry and marine	11.0	10.6	12.2	12.6	12.9	59.3	17.1	11.6
Pilotages	2.0	2.0	4.0	6.0	9.0	23.0	3.0	3.0
St. Lawrence Seaway	25.4	26.9	27.3	28.7	37.4	145.7	2.0	2.0
Ports Corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Canada Ports Corporation	2.8	32.1	20.0	83.6	11.8	150.3	0.6	0.0
Canarctic	6.0	8.0	8.0	10.0	8.0	40.0	2.7	0.0
Subtotal Marine	\$ 207.7	\$ 379.3	\$ 261.1	\$ 313.3	\$ 261.5	\$ 1,422.9	\$ 213.0	\$ 201.3
Strategic Capital Investment Initiatives	0.0	0.0	0.0	0.0	0.0		140.0	129.0
Atlantic Region Freight Assistance Act	69.4	75.6	75.9	100.2	88.3	409.4	87.6	82.8
Nfld	30.0	44.0	45.0	19.0	61.0	199.0	51.0	51.0
NB	34.0	26.0	24.0	21.0	6.0	111.0	6.7	10.7
Que	7.0	9.0	11.0	4.0	20.0	51.0	10.7	2.3
PEI	4.0	2.0	2.0	5.0	3.0	16.0	3.8	0.0
NS	6.0	19.0	15.0	8.0	10.0	58.0	5.0	0.0
Man	5.0	0.0	0.0	0.0	0.0	5.0	0.0	0.0
Yellowhead	14.0	11.0	13.0	1.0	0.0	39.0	0.0	0.0
Subtotal Road	\$ 169.4	\$ 186.6	\$ 185.9	\$ 158.2	\$ 188.3	\$ 888.4	\$ 304.8	\$ 275.8
Contributions to Airports	42.7	47.7	34.4	31.2	32.6	188.6	39.8	38.0
Subtotal Air	\$ 42.7	\$ 47.7	\$ 34.4	\$ 31.2	\$ 32.6	\$ 188.6	\$ 39.8	\$ 38.0
DIRECT SUBSIDIES	\$ 2,022.9	\$ 1,820.7	\$ 1,661.7	\$ 2,114.7	\$ 1,650.2	\$ 9,270.2	\$ 1,704.3	\$ 1,588.3

Exhibit 6A.1 (cont'd)

	1988-89 Actual	1989-90 Actual	1990-91 Actual	1991-92 Actual	1992-93 Actual	Five Year	1993-94 Estimate	1994-95 Estimate
INDIRECT SUBSIDIES								
Aviation	724.3	815.5	828.3	766.0	758.0	3,892.1	767.2	780.2
Marine	697.2	780.0	681.8	632.7	606.7	3,398.4	687.1	601.7
Airports	594.8	586.0	571.8	483.5	408.1	2,644.2	366.7	365.4
Expenditures	\$ 2,016.3	\$ 2,181.5	\$ 2,081.9	\$ 1,882.2	\$ 1,772.8	\$ 9,934.7	\$ 1,821.0	\$ 1,747.3
less								
Revenue	\$ 1,018.9	\$ 1,052.3	\$ 1,094.6	\$ 1,043.3	\$ 965.1	\$ 5,174.2	\$ 899.2	\$ 902.5
NET INDIRECT SUBSIDY	\$ 997.4	\$ 1,129.2	\$ 987.3	\$ 838.9	\$ 807.7	\$ 4,760.5	\$ 921.8	\$ 844.8
TOTAL DIRECT AND INDIRECT SUBSIDIES	\$ 3,020.3	\$ 2,949.9	\$ 2,649.0	\$ 2,953.6	\$ 2,457.9	\$14,030.7	\$ 2,626.1	\$ 2,433.1

Note: The Feed Freight Assistance Program – Agriculture and Agri-Food Canada, payments for the maintenance of highways in Canada's parks and payments for highways made through Public Works are not included. Federal fuel tax revenues are recorded as general revenue and therefore they have not been offset against federal transportation expenditures. This comment also applies to exhibits 6.1 to 6.6.

Exhibit 6A.2

Details on Direct and Indirect Federal Transportation Subsidies for 1988-89 to 1994-95

\$ Millions per Fiscal Year

CPI Adjusted

	1988-89 Actual	1989-90 Actual	1990-91 Actual	1991-92 Actual	1992-93 Actual	Five Year	1993-94 Estimate	1994-95 Estimate
DIRECT SUBSIDIES								
Western Grain Transportation Act	\$ 777.3	\$ 541.7	\$ 586.3	\$ 902.8	\$ 612.5	\$ 3,420.6	\$ 599.4	\$ 539.9
VIA	607.4	496.3	401.4	374.4	310.4	2,189.9	283.3	274.8
Branch Lines Uneconomic	17.7	17.4	19.1	23.8	18.9	96.9	13.8	21.4
Lease of grain cars	15.3	14.2	13.7	12.8	12.7	68.7	11.6	12.9
Rail Crossing And Relocation	14.3	15.3	14.5	9.7	6.4	60.2	7.4	12.5
Atlantic Region Freight Assistance Act - rail	9.0	10.4	10.2	11.2	9.3	50.1	11.7	11.1
Maritime Freight Rate Act	12.9	10.5	9.7	7.7	9.2	50.0	8.0	7.6
Passenger Services	8.4	6.2	4.7	14.4	9.7	43.4	7.6	7.5
Strategic Capital Investments/Initiatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.7
Grain Subsidy	45.4	7.8	0.0	0.0	0.0	53.2	0.0	0.0
Branchline Rehabilitation	28.6	5.2	0.0	0.0	0.0	33.8	0.0	0.0
Branch Lines Unprotected	3.7	0.2	2.9	0.0	0.0	6.8	0.0	0.0
Branch Lines Protected	3.9	0.4	10.5	0.0	0.0	14.8	0.0	0.0
At&East	40.4	24.0	0.0	0.0	0.0	64.4	0.0	0.0
Railway Relocation	3.0	0.0	0.0	0.0	0.0	3.0	0.0	0.0
Montreal commuter trains	8.0	0.0	0.0	0.0	0.0	8.0	0.0	0.0
Other	7.8	0.0	0.0	30.6	0.4	38.8	3.3	0.0
Subtotal Rail	\$ 1,603.1	\$ 1,149.6	\$ 1,073.0	\$ 1,387.4	\$ 989.5	\$ 6,202.6	\$ 946.1	\$ 891.4
Marine Atlantic	135.3	256.0	130.8	109.5	111.3	742.9	109.2	106.1
Jacques Cartier Champlain Bridge Incorporated	8.8	13.2	25.4	22.7	26.7	96.8	30.4	30.7
BC ferry	16.4	16.2	16.2	16.2	16.6	81.6	15.2	15.8
Other ferry and marine	11.0	10.1	11.1	10.8	10.9	53.9	14.1	9.6
Pilotages	2.0	1.9	3.6	5.2	7.6	20.3	2.5	2.5
St. Lawrence Seaway	25.4	25.6	24.8	24.7	31.7	132.2	1.7	1.7
Ports Corporations	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Canada Ports Corporation	2.8	30.6	18.2	71.9	10.0	133.5	0.5	0.0
Canarctic	6.0	7.6	7.3	8.6	6.8	36.3	2.2	0.0
Subtotal Marine	\$ 207.7	\$ 361.2	\$ 237.4	\$ 269.6	\$ 221.6	\$ 1,297.5	\$ 175.8	\$ 167.2
Strategic Capital Investment Initiatives	0.0	0.0	0.0	0.0	0.0		115.5	107.1
Atlantic Region Freight Assistance Act	69.4	72.0	69.0	86.2	74.8	371.4	72.3	68.8
Nfld	30.0	41.9	40.9	16.4	51.7	180.9	42.1	42.4
NB	34.0	24.8	21.8	18.1	5.1	103.8	5.5	8.9
Que	7.0	8.6	10.0	3.4	16.9	45.9	8.8	1.9
PEI	4.0	1.9	1.8	4.3	2.5	14.5	3.1	0.0
NS	6.0	18.1	13.6	6.9	8.5	53.1	4.1	0.0
Man	5.0	0.0	0.0	0.0	0.0	5.0	0.0	0.0
Yellowhead	14.0	10.5	11.8	0.9	0.0	37.2	0.0	0.0
Subtotal Road	\$ 169.4	\$ 177.8	\$ 168.9	\$ 136.2	\$ 159.5	\$ 811.8	\$ 251.4	\$ 229.1
Contributions to Airports	42.7	45.4	31.3	26.9	27.6	173.9	32.8	31.6
Subtotal Air	\$ 42.7	\$ 45.4	\$ 31.3	\$ 26.9	\$ 27.6	\$ 173.9	\$ 32.8	\$ 31.6
DIRECT SUBSIDIES- CPI ADJUSTED	\$ 2,022.9	\$ 1,734.0	\$ 1,510.6	\$ 1,820.1	\$ 1,398.2	\$ 8,485.8	\$ 1,406.1	\$ 1,319.3

Exhibit 6A.2 (cont'd)

	1988-89 Actual	1989-90 Actual	1990-91 Actual	1991-92 Actual	1992-93 Actual	Five Year	1993-94 Estimate	1994-95 Estimate
INDIRECT SUBSIDIES								
Aviation	724.3	776.6	753.0	659.2	642.4	3,555.5	633.0	648.0
Marine	697.2	742.9	619.8	544.5	514.2	3,118.6	566.9	499.8
Airports	594.8	558.1	519.8	416.1	345.8	2,434.6	302.6	303.5
EXPENDITURES	\$ 2,016.3	\$ 2,077.6	\$ 1,892.6	\$ 1,619.8	\$ 1,502.4	\$ 9,108.7	\$ 1,502.5	\$ 1,451.3
less								
REVENUE	\$ 1,018.9	\$ 1,002.2	\$ 995.1	\$ 897.8	\$ 817.9	\$ 4,731.9	\$ 741.9	\$ 749.7
NET INDIRECT SUBSIDY	\$ 997.4	\$ 1,075.4	\$ 897.5	\$ 722.0	\$ 684.5	\$ 4,376.8	\$ 760.6	\$ 701.6
TOTAL SUBSIDIES	\$ 3,020.3	\$ 2,809.4	\$ 2,408.1	\$ 2,542.1	\$ 2,082.7	\$12,862.6	\$ 2,166.7	\$ 2,020.9

Note: The figures in this table have been adjusted for changes in the CPI (1988=100).

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 7
Travel and Hospitality

Chapter 8
Travel Under Foreign Service Directives

May 1995

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 7
Travel and Hospitality

Chapter 8
Travel Under Foreign Service Directives



May 1995

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Chapter 7

Travel and Hospitality

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Travel and Hospitality

Assistant Auditor General: David H. Roth

Responsible Auditor: Trevor R. Shaw

Main Points

7.1 Travel is needed to deliver government programs. Travel is expensive by nature. Travel expenditures were \$685 million in 1993-94, in addition to the value of the time of public servants when travelling and to the cost of travel administration. Overall, we found that the management and accountability for travel can be improved.

7.2 Our audit confirmed that there is a low risk of widespread non-compliance with rules governing travel entitlements. Although data are available at the responsibility centre level, information is not organized for senior management to efficiently assess the need for and costs of travel in relation to program benefits. Travel is administered through a system of entitlements. A rule-based system has advantages. However, more emphasis on a values-driven system may lead to more cost-effective travel and better employee morale.

7.3 For the majority of air travel, public servants use economy class. During 1993-94, the Government Travel Service booked more than 230,000 tickets for air travel. Of these, over 93 percent were economy class and less than 7 percent were first class and business class.

7.4 Departments are working to reduce travel costs. Purchasing discounted economy-class tickets through the Government Travel Service saved the government \$37.7 million during 1993-94. Opportunities for further savings include greater use of technology to replace travel, arranging direct discounts for air travel, and extended use of charter air services. Automation and streamlined procedures have the potential for improving control and reducing the cost of travel administration. Pursuit of these opportunities will require focussed effort and co-operation among central agencies and departments.

7.5 Hospitality spending of all departments is not significant in total. Half the spending is concentrated in two departments: Foreign Affairs and International Trade, and National Defence.

Introduction

Why We Did This Audit

7.6 We last reported on public service travel in 1984. It is time to do so again because government travel can be a visible indicator of prudence and probity in the management of public funds during a period of change and fiscal restraint. Government travel and hospitality are subject to ongoing scrutiny by the public and the media. The public is likely to relate more easily to these activities than to billion-dollar programs. This year, besides examining public service travel, we audited government hospitality for the first time.

Audit Objective, Scope and Approach

7.7 The primary goal of the audit was to assess the management of public servant travel and of hospitality spending by departments. The audit was not designed to detect fraud and abuse since this would not have been an efficient use of our audit resources. However, we reviewed the control environment and systems to prevent and detect irregularities, and the actions taken when cases of fraud and abuse arise. Our primary focus was on how central agencies and operating departments:

- link travel and hospitality spending to program needs;
- consider alternatives to travel;
- achieve lowest or optimum cost;
- manage and control travel;
- ensure compliance with directives; and
- exercise accountability for travel and hospitality.

7.8 The audit focussed on business travel of departments and agencies. It excluded three types of travel. We did not audit travel entailed in moving employees, because of its specialized nature. We did not audit the cost of government-paid travel for people who are not public servants, such as travel provided for First Nations people so they may receive health services. Travel associated with these types of programs is examined as part of value-for-money audits of the programs. We also excluded from our audit the travel claims by ministers and other members of Parliament because this Office commented on such travel in our annual reports between 1989 and 1991.

7.9 Interviews, information analysis, observation, and transaction testing were the primary audit techniques we used. Our audit also relied on available studies and internal audit reports. For purposes of comparison, we conducted research on the management of travel in the private sector and in the United States government.

7.10 We reviewed the central functions of the Treasury Board Secretariat and Public Works and Government Services Canada relating to travel. The travel activity in 10 representative departments was examined: Agriculture and Agri-Food Canada; Environment Canada; Foreign Affairs and International Trade; Health Canada; Industry Canada; Fisheries and Oceans Canada; National Defence; Natural Resources Canada; Transport Canada; and Veterans Affairs Canada. These departments account for about 57 percent of the total spent by all departments on travel by public servants.

7.11 We reviewed the hospitality activities of two departments that make up 50 percent of the total hospitality spending by all departments. Those two departments examined were National

Defence; and Foreign Affairs and International Trade.

Background Information

7.12 The Treasury Board Travel Directive and Travel Administration Guide govern travel by public servants employed by the Treasury Board. Under foreign service directives, the Treasury Board also provides travel allowances to public servants working abroad. We estimate that Treasury Board authority and accountability extend to about 63 percent of total travel spending. The remaining 37 percent represents travel spending by departments that have separate travel policies. These are primarily for uniformed personnel of National Defence and the Royal Canadian Mounted Police.

7.13 The Treasury Board delegates responsibility for travel administration to deputy heads of departments, who then generally delegate it to their senior financial officers or other heads of services. Responsibility centre managers in departments must manage travel among many other tasks. In practice, many thousands of public servants across hundreds of organizational units and many regions play a part in the administration and results of travel.

7.14 With some exceptions, departments must use the central Government Travel Service to arrange commercial air transportation. According to Public Works and Government Services Canada, travel by 60 percent of all public service employees falls under the central Government Travel Service program. National Defence arranges its own travel, although it is expected to begin using the Government Travel Service during 1995. Foreign Affairs and International Trade uses the Government Travel Service but it also uses other travel agents in Canada for special purposes, as well as travel agents

in foreign countries to service Canadian posts abroad.

Perceptions about Travel

7.15 Although government travel is often on public view, the government does not provide information that allows for a good understanding of it. Varied perceptions, combined with a lack of information about travel, appear to have produced an uneven understanding of government travel both inside and outside the public service. The feedback we received showed a wide range of concerns:

- Shrinking budgets require that managers make informed decisions on the need for travel and on who should travel. While some managers express a concern that unnecessary travel is taking place, others are concerned that necessary travel is not taking place.
- Travel can be seen as a privilege. Those who do not travel may see it as a form of reward, the reserve of senior people. But those who must travel frequently may not consider it a “perk” and feel that it takes too much time away from family.
- Travel claims are based, in part, on detailed entitlements set out in various policies. As a result, there are some concerns about the lack of incentive to reduce travel costs and about high costs of travel administration.
- Some managers would prefer fewer rules and more flexibility in approving travel. Others feel that rules of entitlement are neutral and reduce the potential for arbitrariness and inconsistency in the treatment of employees.
- Preparing and processing a travel claim can be time-consuming and frustrating. Solutions to this are being considered by central agencies.

Observations and Recommendations

Need for Communication to Understand Travel and Demonstrate Accountability

Why public servants travel

7.16 The delivery of government programs and operations depends on travel. Travel takes place because programs require it. For example, travel takes place for such things as weights and measures inspections, food inspections, international trade negotiations, enforcement of environmental regulations, tax and other audits, and mapping the regions and resources of Canada. Public servants travel to meet the public in their homes, communities and places of work. This helps make the federal public service more visible to Canadians. Public servants are expected to travel as a condition of employment or work.

7.17 Travel also takes place for purposes such as conference attendance and training. Increases or decreases in such travel may have long-term effects on program delivery. For example, scientists and other specialists travel for development and training to keep up-to-date in today's rapidly changing world. Reduced or limited access to travel can impede the development and retention of research and laboratory capabilities.

Accountability for travel

7.18 Information published about government travel has the potential to build people's confidence in government. Simple accountability questions might be: Why is travel by public servants necessary and what does it cost? Does travel take place only when necessary and at least

possible cost? If these questions were posed today, the federal government could not answer them easily. Given the current emphasis on processing and controlling individual travel transactions and claims, responding to such questions would be difficult at an aggregate level.

7.19 The Treasury Board Secretariat and departments do not have the framework or process to assemble information that would lead to a comprehensive understanding and appreciation of travel. For example:

- The annual spending Estimates and the Public Accounts of the federal government are not designed to report on travel spending by departments and agencies.
- Information about the purpose, costs and benefits of travel is not readily available. There is no reliable measurement of the cost of travel administration. There is no measurement of the number of trips taken or the amount of time employees spend in travel status.
- Many specialized terms are used that can be difficult to understand without intimate knowledge of government travel. This creates a barrier to effective communication, and arises from a travel directive that serves as a collective agreement with employees.
- Departments do not assess the collective need for travel and its costs. Assessments to focus management attention on areas of risk are not common. Managers may not receive analysis of the results of claim verifications so that systemic problems can be addressed.
- According to a Treasury Board listing of internal audits, only five have been completed since 1988 that deal with travel as the single subject. However, at the time we were completing our audit report, Transport Canada had just completed a report on its first department-wide internal audit of travel.

The delivery of government programs and operations depends on travel.

The government does little to foster a broad understanding and appreciation of travel.

Two other departments began audits of travel in October 1994.

7.20 Our work indicates that travel is an integral part of government operations and is one resource for program delivery. At the same time, travel represents a considerable investment of time and money for the government as a whole. The government does little to foster a broad understanding and appreciation of travel among the public, the media and public servants.

7.21 The challenge for government is to give transparency to program results and costs. Currently, a shift in focus from managing inputs to managing outputs and outcomes is an overall goal of the government. As part of this shift, for management and accountability purposes better information is needed about the benefits and costs of travel.

7.22 Supplying a government-wide report on travel once every three or four years would require agreement on the need for it and co-operation between central agencies and departments to produce it. Such reporting might begin by showing the link between travel and program delivery requirements. This type of information might also support departments when choosing priorities for

limited travel dollars and deciding how best to manage costs. Existing data sources could be used to construct meaningful information about travel activity in the federal government. Producing such a report would also require improving the sources of information and, where feasible, using automated travel management systems.

7.23 As information systems become better developed, the Treasury Board Secretariat should consider providing, on a cost-effective basis, public information that would enhance accountability and build a better understanding of government travel in relation to program requirements and costs.

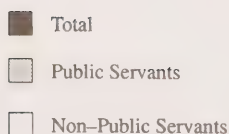
How much is spent on travel?

7.24 The central accounting system classifies travel expenditures into two basic categories: public servant and "non-public servant" travel. For accounting purposes, public servant travel includes travel by civilian public servants, military personnel and members of the RCMP. Travel by ministers and their staff is charged to departmental accounts as "public servant travel" when it relates to programs for which a minister is responsible. Non-public servant travel includes, for example, transportation provided to First Nations people and war veterans who receive health and social services.

7.25 According to the central accounting system, departments and agencies spent \$808 million on travel for the fiscal year 1993-94 (Exhibit 7.1). Of this total, \$622 million (77 percent) was for travel by public servants and \$186 million (23 percent) was for non-public servant travel. The total amount spent on travel is less than 1 percent of total annual expenditures and

Exhibit 7.1

Travel Spending of Departments



Source: Central Agencies Information System (CAIS)

less than 5 percent of spending on departmental operations.

7.26 Because of classification differences (not errors), the \$622 million does not include amounts paid for specialized purposes such as travel for moving employees, and travel-related foreign service allowances paid to employees when posted abroad. Two of these allowances, for example, are for education travel and vacation travel assistance.

7.27 Payments under foreign service allowances are classified as part of salary and benefit expenditures and not as travel expenditures. In 1993-94, travel-related allowances totalled \$14.5 million at Foreign Affairs and International Trade, primarily made up of vacation travel assistance, leave-related travel and family reunion travel. Similarly, National Defence classified \$39 million of travel-related expenditures in categories other than travel. This amount includes aircraft rentals, landing fees, payment for a travel reservation system, and travel assistance for employees. Errors in classifying expenditures can also have an impact on the compilation of travel spending. National Defence incorrectly coded \$13 million as travel by non-public servants during the 1993-94 fiscal year.

7.28 Compiling a profile of travel spending by the federal government is not a simple matter. After taking classification differences and known errors into account, the total spent by departments on various forms of public servant travel was over \$685 million in 1993-94. This figure answers a question about travel spending, but does not measure all costs relating to travel and does not explain why it is essential. Producing information for accountability will depend on the development of better information for management.

Lack of management information

7.29 Information is needed to provide:

- the means for management to use travel better to support individual managers when planning and authorizing travel;
- broad detail about travel patterns and costs, for use by central agencies to assess policies and alternatives and to help improve the economy and efficiency of travel; and
- assurance to ministers and the public that government travel is being managed with due regard to prudence and probity.

7.30 Financial systems capture travel advances and expenditures and charge them to budgets. They are not designed to measure the component costs of travel or to produce information about the purposes of travel. While detailed transaction data are available at the travel authorization level, information is not always available for senior management to efficiently scrutinize the uses and costs of travel. Departments do not measure indirect costs such as the cost to arrange and administer travel. Information to manage travel is limited mostly to what is spent, with much less information available about travel patterns in terms of purpose and costs.

7.31 Travel administration guidelines issued by the Treasury Board expect that departmental systems will prevent duplication of pre-audit and post-audit of travel claims, compile information on the results from checking claims, and compile and retrieve data that managers can use to improve travel practices. However, the design of departmental systems precludes capturing this type of information in an efficient way that is useful for management.

7.32 Travel forms and claims document the authority for travel and provide evidence in support of payments.

Compiling a profile of travel spending by the federal government is not a simple matter.

Automation offers the potential to improve control while reducing the cost of administration.

Overall, widespread non-compliance by public servants with rules of travel entitlements is a low risk for the government.

Travel claims are of limited use as management information because of their paper format and the need for tedious cross-referencing to assemble information. Potentially useful information about air travel is available in the travel agent reports but departments have shown little interest in them. The reports are voluminous and require manual review to highlight unusual travel. They also require considerable analysis for efficient scrutiny and interpretation by management. A new on-line reporting system is anticipated from the Government Travel Service during 1995 to enable departments to develop the reports they require.

7.33 Automation offers the potential to improve control while reducing the cost of administration. Automated travel management systems are currently being pilot-tested; none are in full use. Unobtrusive controls can be built into automated systems to guide travellers and managers. Electronic systems can provide the opportunity to identify anomalies in trends and sensitive or unusual transactions before travel takes place. Automation also offers the opportunity to share travel information among managers. This may help departments reduce costs by consolidating trips, which, for example, Environment Canada is doing.

7.34 In co-operation with departments, the Treasury Board Secretariat should help specify the information needed to manage travel better. The Secretariat should pursue the implementation of automated travel systems appropriate for government purposes.

The risk of non-compliance with rules of travel entitlements

7.35 Overall, widespread non-compliance by public servants with

rules of travel entitlements is a low risk for the government. This assessment, with appropriate reservations, is based on the following:

- There are well-established policies and procedures to begin travel and to limit expenses through prescribed entitlements. However, information is commonly not available for management to scrutinize travel use and costs.
- The government standard for air travel is economy class. More than 93 percent of air travel booked in 1993-94 by the Government Travel Service was at full economy fare or lower.
- Managers are increasingly aware of travel costs; there are indications that responsibility centre managers consider travel requirements and expenditures when developing and controlling their budgets. However, a limitation is the lack of periodic assessments to review the overall need and priorities for travel and whether travel takes place at least cost.
- Travel claims are checked manually and extensively for compliance with entitlements. Use of a single travel service and departmental travel accounts provide a check and balance on air travel transactions. Basic internal controls are in place, but they could be more efficient and effective.
- Budget constraints and potential for public exposure are deterrents to waste and abuse.
- Our tests of travel claims for system compliance revealed no major problems. However, rules for using business-class air travel need further clarification.

Using Information to Show if Expectations Are Being Met

High expectations

7.36 Air travel makes up about 35 percent of total travel expenditures by departments. During 1993-94, the

Government Travel Service provided more than 230,000 tickets with a value of \$165.8 million excluding taxes and refunds. In addition, National Defence directly booked more than 88,000 tickets with a value of \$57 million.

7.37 Successive governments have had high expectations about the use of travel. For example, according to 1992 Budget papers, tighter government travel guidelines were to be implemented. Departments were to eliminate first-class air travel, discourage business class, restrict travellers to standard accommodation, continue the 20 percent reduction in the number of foreign trips, reduce the size of delegations, and reduce participation in international meetings and conferences. It was not clear how this was to be accomplished. Departments were expected to comply with this direction in the way they saw best.

7.38 We expected there would be effective monitoring by departments of first-class and business-class air travel based on complete and accurate records. However, this was not evident. Specifically, we found that departments tend not to acquire and aggregate data from the Government Travel Service for analytical purposes. Departments make little use of travel agent reports that detail the booking of upgraded air travel.

National Defence does not track first-class and business-class tickets. The Department informed us that these would be a small percentage of total air travel, and that it plans to generate the analytical data in 1995.

7.39 We gathered data and found that over 93 percent of the air travel tickets booked through the Government Travel Service in 1993-94 were at full or discounted economy-class fares (Exhibit 7.2). This shows a high degree of compliance with the government's general standard to fly economy class. Less than one half of one percent of the tickets were first class and less than seven percent were business class. In monetary terms, first-class and business-class bookings amounted to \$29.7 million, representing 18 percent of the value of all tickets booked by the Government Travel Service.

Analysis of first-class air travel

7.40 In 1993-94, 884 first-class bookings were made for departments by the Government Travel Service. From these, 855 tickets were invoiced to departments in the amount of \$2.9 million. Approximately 50 percent of all these first-class tickets were issued to ministers, deputy ministers and other senior officials and managers; 40 percent

Over 93 percent of the air travel tickets booked through the Government Travel Service in 1993-94 were at full or discounted economy-class fares.

Exhibit 7.2

Summary of Commercial Airline Ticket Bookings for Departments by the Government Travel Service

Class of Ticket	1992-93	%	1993-94	%
First Class	731	0.3%	884	0.4%
Business Class	14,917	6.1%	15,066	6.5%
Economy Class	228,171	93.6%	214,343	93.1%
Total	243,819	100%	230,293	100%

Note: There are other departments (e.g. Foreign Affairs and National Defence) that are serviced by agents other than the Government Travel Service. The above, therefore, does not capture all commercial tickets acquired by all departments and agencies.

Source: Agent Reports to Public Works and Government Services Canada

were issued to foreign service couriers; and 10 percent to other individuals.

7.41 Foreign Affairs and International Trade booked about half of all the first-class air travel arranged through the central Government Travel Service. Of the remaining entities, 54 had no first-class bookings while 37 had at least one. Six entities, including Foreign Affairs and International Trade, had 25 or more first-class bookings.

7.42 The use of first-class air travel at Foreign Affairs and International Trade is due to the nature of operations and the amount of international travel. An examination of the Department's records revealed the following:

- The Department paid \$1.6 million for the 353 first-class tickets that were issued through the Government Travel Service in 1993-94. Diplomatic couriers travelling first class for security and other reasons accounted for 269 (77 percent) of the Department's first-class tickets. Starting in April 1994, courier activity has been reduced while the Department assesses alternatives.
- Travel at the minister and deputy minister levels accounted for 32 of the first-class tickets; transportation of other senior officials, including ambassadors and high commissioners, accounted for the remaining 52 tickets. Effective January 1994, one departmental auditor checks all travel claims by senior officials and senior managers. These internal verifications have identified no problems.
- Information is not assembled on the extent to which first-class or business-class tickets are purchased through other travel agents in Canada or abroad.
- The control process with respect to authorizing first-class travel was deficient in Foreign Affairs and International Trade.

The Department has informed us that corrective steps will be taken.

7.43 For the government as a whole, the elimination of first-class travel would not significantly reduce total costs since it is a small proportion of total air travel. Assuming that the need for travel continues, either business or economy class will likely replace first class. Completely prohibiting first-class travel may be impractical. Unusual circumstances may require it, such as emergencies or the medical condition of a traveller.

7.44 In conclusion, use of first class is concentrated in a few departments. Steps are being taken to reduce its use.

Analysis of business-class air travel

7.45 More than 15,000 bookings for business-class flights were made by departments through the Government Travel Service for the fiscal year ended 31 March 1994. The value of these was \$26.8 million. This represents 16.2 percent of the total value of all tickets arranged through the Government Travel Service. Sixteen departments accounted for 75 percent of this business-class air travel.

7.46 The use of business-class travel by ministers, deputy ministers and Governor in Council appointees is entirely at their personal discretion. For others, there are various distance or time rules that apply to air travel one way and not to a round trip. Briefly, the rules are the following:

- Starting in 1989, the Treasury Board allows business class to members of the Executive Group (senior managers) when a trip is more than 850 air kilometres one way. This was done because it provides a better environment for working in transit and many managers travel on weekends or after normal working hours.

- Business class is provided to other employees if requested, and when flights exceed 12 continuous hours or one direct flight exceeds 9 hours.

- The Travel Directive also allows business class in exceptional cases or for program-related reasons such as security. Such exceptions are not limited by distance, time or the level of the employee.

7.47 There is potential for confusion in applying the rules on the use of business class. For example, the Travel Directive states: “Previously, the Treasury Board authorized the use of business-class air travel for trips of 850 air kilometres or more one way.” This implies that the rule has changed. However, the Directive does not state a new rule, nor does it withdraw the 850 kilometre rule that applies to some 3,700 senior managers. We also found that there could be confusion over what constitutes a “trip” for purposes of applying policy.

7.48 The Treasury Board Secretariat informed us that, while the 1992 Budget directed deputies to reduce the use of business class, it did not eliminate or change the entitlements for represented employees that form part of collective agreements approved by the Treasury Board. And certain executives and equivalents, specified by level, are entitled as a term of employment to travel business class on trips in excess of 850 kilometres one way. Accordingly, it appears that departments were expected to reduce the use of business class although entitlement rules for non-management remained, but departments could adopt different rules for managers.

7.49 At the same time, Treasury Board Secretariat indicated to us that there is no longer one standard rule for senior executives to use business class. This

suggests that departments can modify the 850 kilometre rule if they wish, but they would still have to respect the rule as an entitlement. We found that the departments we audited generally retain the 850 kilometre rule as part of their administrative policies. Three departments were noted to have recently replaced this rule, and now permit the use of business class only when total air time will exceed three hours and/or 1,700 kilometres one way.

7.50 Departments are making an effort to reduce the use of business-class air travel. Seven of 10 departments included in our audit reduced the number of business-class reservations over a period of one year. Industry Canada reduced business-class air travel by almost 50 percent. However, a goal of reducing business-class travel in departments overall has yet to be reached. The aggregate bookings of all departments remained almost constant over the 1993 and 1994 fiscal years.

7.51 To diagnose patterns of business-class air travel, we analyzed 6,447 tickets that included flights designated for business-class seating. These were billed by the Government Travel Service to departments from January 1994 to April 1994. Invoices totalled \$9.9 million. These tickets contained individual flights designated for business-class seating that made up 10,493 “one-way trips” from point of departure to point of arrival, without stopover (as defined in Exhibit 7.3). This reflects continuous travel one way, the basis for rules of the Treasury Board. In terms of “round trips”, approximately 5,500 were taken over the four-month period. About 63 percent of the business-class travel took place in Canada and the United States, and 37 percent involved destinations overseas.

Departments are making an effort to reduce the use of business-class air travel.

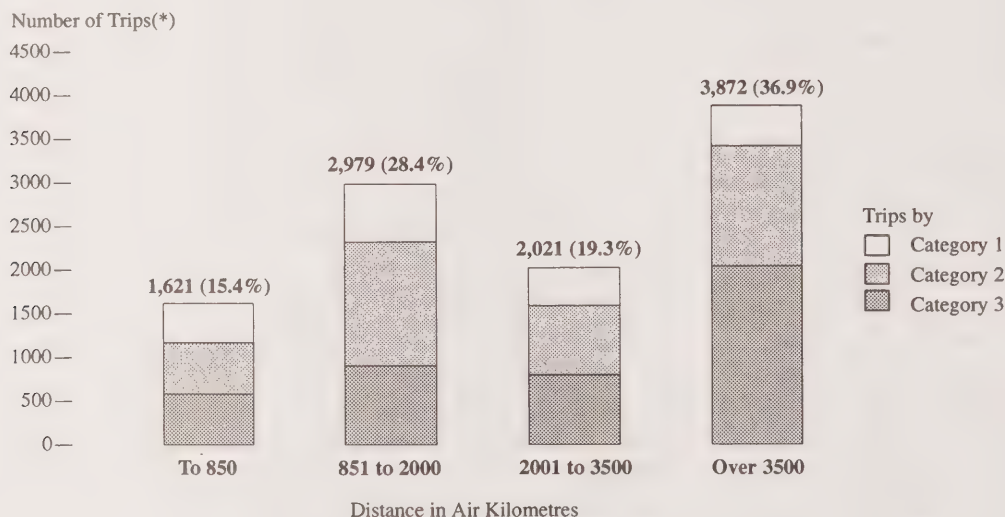
7.52 We measured the use of business class in terms of who was flying and distances flown. On a flight-by-flight basis, more than 72 percent were for distances of less than 3,500 air kilometres one way (generally less than five to six hours). On the basis of trips as defined and shown in Exhibit 7.3, about 44 percent of business-class use involved air travel of less than 2,000 air kilometres (less than three to four hours) and 15 percent involved less than 850 air kilometres (about 1.5 hours) one way. This analysis indicates that business class is being used for short distances.

7.53 In relation to business-class air travel, specialized terminology, intricate rules and lack of information make it more difficult to achieve compliance with policy. Our analysis shows a risk that up to 25 percent of business-class air travel is inconsistent with basic distance and time rules. This is an issue for the Treasury Board Secretariat and departments to examine further.

7.54 If it were possible to replace all business-class air travel with full economy fares, we estimate the potential saving would be approximately \$4 million a year;

Exhibit 7.3

BUSINESS-CLASS Air Trips Paid by Departments Analyzed by Distances Flown in the Four Month Period January 1994 to April 1994



(*) For purposes of this analysis, a trip is one or more days' continuous air travel one way and is measured by the total air distance flown between point of departure and arrival. There can be more than one flight in a trip.

For purposes of this analysis, we have used the following categorization:

Category 1 includes: ministers, deputy ministers, Governor in Council appointees, exempt staff

Category 2 includes: members of Executive category (commonly director level and above)

Category 3 includes: employees who are non-management, diplomatic couriers, astronauts and those who could not otherwise be categorized

Source: Data provided by travel agency operating the Government Travel Service

more if replaced by discounted economy-class fares. However, making such a change would not be easy and business-class travel is desirable from a number of standpoints. The need for travel and the effects on productivity would have to be assessed; entitlements may require renegotiation with employees; and departments would have to implement additional control measures. Upgraded air travel has to be managed in an informed and prudent way.

7.55 In conclusion, the vast majority of public servants use economy class when they fly. The use of first class and business class represents less than 7 percent of air travel. In keeping with fiscal restraint, senior public servants might avoid using business class on short trips. Since senior officials and managers account for more than half the use of upgraded air travel, they may wish to consider the example they set for others. For better management, departments and central agencies could use diagnostic information to periodically monitor the use of upgraded air travel.

7.56 The Treasury Board Secretariat should assess and further clarify the application of policy for business-class travel. Departments should develop better information on the use of upgraded air travel.

Acknowledging the Role of Values in Travel Activity

Values for achieving control

7.57 In our 1990 Report, we pointed out that values influence which tasks people will do with care, which they will do superficially, and which they will try to avoid. Principles of integrity and ethical values can contribute to control by supporting policies and providing a guide to decision and action. The attitudes and

behaviour of managers toward leadership by example, compliance with policy, and integrity of transactions and records can influence the behaviour of other people. These factors can set a foundation for incentive-based management.

7.58 There are potentially *three types of rules* that can influence travel activity and costs. **Rules of entitlement** cover, for example, modes of air transportation, various rates of reimbursement for using personal vehicles and various meal and incidental allowance rates for travel in Canada. **Rules of administration** include the requirement that a traveller obtain prior authorization to travel, and use an authorized form to submit claims.

7.59 The emphasis in travel management has been on rules of entitlement and administration. Less evident are **rules or principles of behaviour** based on organizational values. For instance, if a value is to achieve least cost in travel, then a rule of behaviour might be to lead by example. Attempts to recognize and reinforce values through travel practices are not evident. As previously noted, little objective information is readily available to tell management about the nature, costs and results of travel.

7.60 In addition to information, the value judgments of public servants play an important role in management of travel. A fundamental control is the decision by a manager or traveller that a trip will support program delivery at a reasonable cost. This is important given that these decisions are made thousands of times a day across government. However, departments do not conduct self-assessment of the need for travel in achieving program aims.

7.61 Managers judge the need for travel when they plan it and when they authorize travel to take place. Once a trip

Value judgments of public servants play an important role.

is authorized, little else remains to the manager's discretion, since rules of entitlement determine modes of transportation and the expenses to be reimbursed.

7.62 The consistent application of shared values such as frugality and prudence could help deal with the complexities of travel management and help motivate better control and cost reduction. Incentives and motivation have a part to play in all aspects of departmental operations, including travel. However, this can be a complex matter in the context of entitlements. The interaction of rules and behaviour has to be carefully studied and considered by the Treasury Board Secretariat. As an illustration, public servants may choose to travel at night or over weekends to save time and money. They may also choose not to request upgraded air travel although entitled to it. Such choices may change when those who have made every effort to economize on transportation are questioned about the cost of a phone call home to say they arrived safely.

7.63 The Treasury Board Secretariat should consider publishing principles of behaviour in government travel that are based on shared values for management in the public service.

Frequent-flyer points

7.64 The issue of frequent-flyer points illustrates that values and rules can reinforce each other and help achieve results when formal controls cannot. Airlines give frequent-flyer points to individual customers at no cost when they buy a ticket. When sufficient points accumulate in a customer's account with an airline, they can use them to obtain free tickets or upgraded air travel. Airlines use frequent-flyer points as an important tool

in developing customer loyalty and increasing their share of the air travel market.

7.65 Frequent-flyer points pose a complex and long-standing problem in government travel. Since point accumulation is not permitted by Treasury Board, it is a problem to ensure that they are not awarded on government-purchased air tickets. The Government Travel Service puts a code in the common air reservation system to signal that a government ticket is not eligible for points. However, this does not prevent the traveller from acquiring points when a ticket is used. Because of the way the point system works, personal use can be made of points accumulated with government tickets whether policy allows them or not. Departments cannot formally control the acquisition and use of points. In our view, it is the value system that serves as the control. Therefore, we feel it is important that public servants understand why a particular policy on travel points exists.

7.66 In prohibiting frequent-flyer points, the government foregoes potential savings. In addition, this policy can be interpreted as being incompatible with public service renewal, which seeks fewer controls on the basis of trust in people and more accountability. Prohibiting the acquisition of points on government travel might be construed as showing lack of confidence that public servants will use accumulated points to reduce the travel costs of their departments and be prepared to account for them.

7.67 The policy on travel bonus points should be assessed by the Treasury Board Secretariat. The reasons for the policy should be explained to public servants.

Reducing Travel Costs and Improving Control

Opportunities to reduce the direct costs of travel

7.68 Over 93 percent of air tickets acquired through the Government Travel Service during the 1993-94 fiscal year were for economy class. Of these, about 46 percent were at discounted economy fares. Achievement and measurement of savings depend on when each flight is booked and the specifications of a traveller. For example, a booking made earlier than 14 days ahead of planned departure has a better chance of a lower fare than one made only a few days in advance. The chances of reducing costs increase when travellers arrange their

flights early. Conversely, the risk of missed discounts increases when travel arrangements are delayed.

7.69 Data in Exhibit 7.4 suggest that departments are increasing their savings on air fares. Of a possible savings of \$50.2 million available at the time of booking flights, public servants collectively realized \$37.7 million from discounted fares. Foregone savings of \$12.5 million could be explained, for example, by the fact that a lower-fare ticket had restrictions that impeded necessary flexibility for the traveller, or involved payment of overtime and accommodation at a cost higher than the potential savings from a discounted air ticket. The cheapest seat is not always the most sensible and the extent of use of

Department	Percentage of Savings Realized Compared to Savings Available	
	1992-93 %	1993-94
Natural Resources Canada	83.28	86.51
Agriculture and Agri-Food Canada	78.33	83.81
Environment Canada	77.41	83.66
Transport Canada	74.84	82.60
Health Canada	70.67	79.50
Fisheries and Oceans Canada	71.42	77.91
Public Works and Government Services Canada	74.13	75.81
Industry Canada	63.99	75.75
Human Resources Development	75.34	74.01
Veterans Affairs Canada	55.34	68.44
Foreign Affairs and International Trade	44.91	45.34
Overall Ratio – All Departments	71.13%	75.10%
Savings Realized (millions) – All Departments	\$ 32.70	\$ 37.70
Savings Not Realized (millions) – All Departments(*)	\$ 13.30	\$ 12.50

Note: These ratios represent a measurement of savings when booking flights, in comparison to the lowest applicable fare appearing in the Computer Reservation System (CRS) at time of booking. Data for the Department of National Defence are not available.

* Readers should be aware that not all of the missed savings would be avoidable, for practical reasons.

Exhibit 7.4

Comparison of the Percentage of Savings Realized at Time of Booking Air Travel with the Government Travel Service

Source: Data provided by Public Works and Government Services Canada

Although departments show an upward trend in savings, there is room to do better.

business class may also affect savings. Therefore, an increase in savings on air fares should be viewed as an objective while recognizing that they would not be attainable 100 percent of the time due to operational constraints.

7.70 Although departments show an upward trend in savings, there is room to do better. This is suggested by the wide range in savings among departments and by the fact that 54 percent of economy tickets were acquired at full fare. Departments and central agencies have not conducted reviews to learn why savings are realized or missed in order to improve results. A lack of sufficient information makes it difficult to learn whether air travel is taking place at the least possible cost.

7.71 Measuring savings realized and not realized is helpful for managing travel costs. However, this has limitations. There can be confusion about how savings are now measured and how to interpret them. Moreover, there is no measurement of the savings that could have been realized had public servants booked flights earlier. It is also possible that the upward trend in savings could have been due, in part, to increased price discounts by the airlines. If fare prices increase, public servants will have to increase their efforts to maintain or improve the current level of savings.

7.72 Under existing arrangements, departments acquire air tickets as though they were private citizens. Savings have to be made on each air ticket, one at a time, one public servant at a time. Savings are not automatic on the some 230,000 or more commercial air tickets acquired through the Government Travel Service. Improving the savings may increase the opportunity cost of people's work time and the cost of travel

administration. Therefore, the question of alternative strategies arises.

7.73 An alternative strategy would be to establish discounts or flat-rate fares directly with the airlines for city-to-city routes commonly travelled by public servants. At one time, starting in 1990, certain discounts were pre-arranged with airlines. Public Works and Government Services Canada informed us that \$5 million to \$8 million a year was lost when the discounts were ended by the airlines in 1992. While the government establishes standard discount rates with hotels for accommodation, discounted or special fares are not established with airlines. An exception is National Defence, which arranges directly with airlines discounts ranging from 8 percent to 50 percent on all fare types. These discounts are made possible because the airlines would otherwise be paying standard commission rates to travel agents. We understand that the discounts will be continued when National Defence joins the Government Travel Service.

7.74 Other strategies to explore are charter services, special off-peak rates, and permitting public servants to transfer discounted tickets to other public servants or arranging with airlines to waive penalties when tickets are cancelled.

7.75 Another potential way to reduce travel costs is to evaluate the duplication or extension of National Defence's use of Service Air. This is a charter service provided by a major Canadian carrier, involving continuous flights across Canada. The Department plans to expand Service Air in April 1995. Information obtained from National Defence shows that, during 1993-94:

- \$19.8 million was paid for Service Air, and passengers numbered 117,590;

- use of Service Air avoided costs of \$10 million over costs of comparable commercial tickets;
- average seat occupancy was 93 percent, ranging from 75 percent to 100 percent; and
- about 75 percent of seat assignments were for duty travel including training, about 23 percent were for personal travel as an earned free perquisite, and about 2 percent represented travel provided for compassionate reasons.

7.76 The savings reported from using Service Air are plausible. We observe that no one outside National Defence has sought to evaluate thoroughly the potential to copy or extend the service beyond the Department. Such an assessment should consider levels of usage, means of access, and possible economic effects of using charter services.

7.77 Finally, travel is expensive and departments are pursuing alternatives. With the advent of technology, travel is no longer the only way to communicate. For example, the government is building shared video-conference facilities in Edmonton. Environment Canada uses telephone conferences, Transport Canada holds monthly video conferences by senior managers, and Veterans Affairs held 130 video conferences during the 1993-94 fiscal year. Departments anticipate further reductions in travel costs as technology advances.

Opportunities to improve control and reduce the cost of travel administration

7.78 Central agencies and departments acknowledge that the cost of travel administration needs to be reduced, but there are no clear goals and action plans to do so. Doing this could make travel administration more efficient and help departments cope with budget reductions.

7.79 The administration of travel is labour- and paper-intensive. While there is no measurement of the cost of travel administration, various sources roughly estimate that the average cost would be between 25 and 35 percent of travel expenditures. Using that range, the government-wide cost to administer travel could be between \$170 million and \$250 million a year, perhaps higher. Efficiency gains of 10 percent could lower that cost by up to \$25 million a year across all departments. A report in 1994 by an outside consultant pointed to the feasibility of achieving savings in that range through automation.

7.80 Another way to appreciate the cost is to consider how much time is spent administering travel. However, central agencies and departments have not conducted studies to determine the time spent planning, arranging, and administering travel. Nonetheless, it is likely that millions of hours are involved across departments. Reducing the time to administer travel by as little as half an hour per event would free employees to serve the public and meet other operational requirements. A combination of automation and simpler ways of obtaining least-cost travel could make a sizable difference.

7.81 In summary, departments are working to reduce travel costs. They are achieving savings in the purchase of air fares. There are opportunities available to reduce the cost of air travel further. Automation and streamlined procedures can improve control and reduce the cost of travel administration. Making travel more efficient and effective requires a combination of many actions by many players. Care must be taken when reducing travel costs to consider program requirements as well as impacts on morale. Until there is better information

A combination of automation and simpler ways of obtaining least-cost travel could make a sizable difference.

and better co-ordination among central agencies and departments, the amount of actual cost reduction achieved will not be known.

Reducing foreign travel – lessons learned

7.82 The government's program for reducing foreign travel by departments began in 1989 and ended in April 1994. Originally implemented for calendar years 1990 and 1991, the program was renewed for a second term for 1992 and 1993. With 1989 as the reference year, the program called for a 20 percent reduction in the number of foreign trips. For purposes of the program, foreign travel was defined as any trip outside Canada, including any to the United States, that started and ended in Canada. Departments monitored foreign trips and certified to the Treasury Board Secretariat their compliance with the 20 percent reduction target of the program.

7.83 It was not clear what a 20 percent reduction in the number of foreign trips was to accomplish. It was not necessarily to lower government expenditures, since any savings generated by a reduction in foreign trips could be spent by departments in other worthwhile areas, including travel within Canada. This was done to help departments cope with budget restraint.

7.84 The basis for measuring reductions in foreign travel was different from the Travel Directive definitions of travel. According to Treasury Board policy, a trip outside continental North America is defined as "overseas travel". This does not include trips to the United States. However, the foreign travel reduction program treated any trip to the United States as "foreign" for purposes of measuring reductions. The impact of this difference in terminology can be

illustrated as follows. A commercial flight from Ottawa to Washington costs less than one to Europe or Asia. However, under the reduction program, one less trip to Washington would count as much toward a 20 percent reduction target as one less trip to Paris or Tokyo. The program may not necessarily have reduced costly overseas travel.

7.85 The effect of the program on travel costs, the level of actual savings achieved, and the extra costs to administer the program were not determined. Departments were not required to report changes in the costs and patterns of travel, including any changes in the duration or destination of trips outside Canada. There was no requirement to correlate the number of foreign trips with costs, savings and operational impacts. The reduction program was also part of the government's intention to increase the use of charters, discounts and other lower-cost fares. Central agencies did not vigorously pursue these areas. However, a special discount of 10 percent on all fares from Canada to foreign destinations was negotiated in 1989 by Public Works and Government Services Canada with two Canada-based airlines. This discount was ended in 1992 by the airlines, while the foreign travel reduction program continued for another two years.

7.86 The foreign travel reduction program ended in April 1994. The program serves to illustrate that attempts to control travel in a narrow or piecemeal way are likely to achieve uncertain, if not limited, results. A more comprehensive approach would pursue options in a co-ordinated way with a view to all costs and program requirements.

Using internal controls more effectively

7.87 The Travel Administration Guide expects that departments will ensure proper audit trails, provide monitoring and

require adequate reporting to achieve effective travel administration. Our audit found considerable divergence in the way departments carry out these internal control requirements.

7.88 While audit trails usually exist, there are limitations or problems in exercising the control process. Checking a travel claim ensures compliance with rules of entitlement but does not assess the need for, and economy of, the travel. Errors are found and corrected during the proof of claims. However, little effort is made to track error rates to find out whether they are at an acceptable level, and to diagnose travel practices for improvement. Moreover, greater use of statistical sampling based on risk assessments could improve the cost-effectiveness of travel administration.

7.89 Our test of travel claims for system compliance also revealed instances of lack of authorization, absence of indication that claims were verified, and poor control over travel advances. However, their small number and the presence of established policies and procedures suggest that these instances represent a low risk.

Role of Central Agencies

Treasury Board Secretariat

7.90 The Treasury Board is a committee of six ministers, created by the *Financial Administration Act*. The Treasury Board Secretariat supports the Board in its responsibility for government administration. As employer, the Treasury Board requires the employee to travel as a condition of work or employment; travel is part of the employer-employee relationship. It is important, therefore, to appreciate how policy is formed and the implications of changing policy to improve travel management.

7.91 There are two main sets of policies that govern travel by public servants. The central one is the Treasury Board Travel Directive. The other consists of foreign service directives. Both sets are scheduled for review on a three-year cycle and are negotiated separately through the National Joint Council. This Council is a consultative body created in 1944 by an order-in-council. It is a means for representatives of the employer and representatives of the unions to come together and agree on policy for such things as travel, relocation, and isolated posts. The Secretariat devotes one senior analyst to the Travel Directive, and one to the foreign service directives.

7.92 The process to formulate the Travel Directive has evolved over 30 years to closely resemble the process of collective bargaining with employees. In May 1994, the step was added of allowing arbitration for new policy items not resolved through negotiation. A key difference is that employees do not vote on travel policy as they would on a collective agreement. Nonetheless, the Treasury Board deems the Travel Directive binding, as though it were a collectively bargained agreement.

7.93 The Treasury Board Secretariat leads the development of input and negotiations in the National Joint Council that result in the Travel Directive. The Travel Directive contains many rules of entitlement and standard amounts for reimbursing employees who travel in Canada, the United States and some 178 foreign countries. The supporting Travel Administration Guide is useful for clarifying entitlements and outlining expectations for travel administration.

7.94 The Travel Directive aims at achieving fair and consistent reimbursement to employees. For

The process to formulate the Travel Directive has evolved over 30 years.

example, entitlement rates to reimburse employees for meals and use of a personal car are based on surveys of actual costs. The Secretariat gauges fairness to employees informally by the number of employee grievances filed with the National Joint Council. There are very few grievances on the subject of travel. The Secretariat also asks for input from departments when there is a review of travel policy, and argues any precedent-setting grievances that might otherwise increase travel costs.

7.95 Policy does not call for systematic government-wide monitoring of travel management or compliance with the Travel Directive. The Secretariat does not obtain information about travel activity and costs to departments. It does not routinely share information on the extent to which departments are using alternatives to travel. The Secretariat does not systematically pursue ways of reducing travel costs, or focus on travel when departments make their annual budget requests. Nor does it monitor the quality of management control over travel, maintain an automated database on component costs of travel, or follow up to determine if departments carry out reviews of the need for and costs of travel as expected by the Travel Administration Guide.

7.96 The Secretariat has been involved in the development of automated-travel expert systems and pilots using automatic teller machines for travel advances. It completed a review of the Travel Directive in November 1994, which reached conclusions similar to those of our audit. The review noted the opportunity to clarify or simplify certain aspects of travel policy. It also found that public servants could make greater use of individual travel cards to reduce travel advances.

7.97 We conclude that there is a well-developed process for issuing the Travel Directive. It is clear and well communicated. The Secretariat would need to do more work to know better whether policy aims are achieved and whether other policy designs would be beneficial to achieving cost-effective travel. We recognize that the Secretariat cannot monitor departmental travel in isolation from other responsibilities, priorities and resources. A review of the Treasury Board Secretariat's overall accountability was under way in 1994.

7.98 The Treasury Board Secretariat should assess possible changes to the Travel Directive and Guide to improve the efficiency and effectiveness of travel and travel administration.

Public Works and Government Services Canada

7.99 The Traffic Management Directorate of Public Works and Government Services Canada is responsible for services related to domestic and international transport of people and goods for government departments and agencies. The Personnel Traffic Division secured through a tendering process the services of the current agent that runs the central Government Travel Service.

7.100 The Government Travel Service arranges travel for public servants. Consistent with industry practice and contract arrangements, the agent is not paid for its services by the federal government. Agent revenues come from commissions paid by the travel industry, primarily airlines. The Government Travel Service arranges about 70 percent of commercial air tickets purchased in Canada by all departments and agencies. It looks after only a small portion of hotel reservations and other forms of transportation such as car rentals and rail.

The Government Travel Service is not responsible for ensuring that public servants comply with government travel policies. Departments are responsible for this.

7.101 Departments are also responsible for achieving least cost in travel. To help them, the Government Travel Service is required to offer public servants reliable travel arrangements at least cost. The travel agent expects public servants to honour the contract, in particular to make exclusive use of the Government Travel Service for air travel.

7.102 The Travel Management Directorate takes assurance in the fact that it receives few formal complaints about the Government Travel Service from departments. According to its files, there were only 11 complaints from departments in the first six months of 1994.

7.103 We have been advised that surveys of travellers are also conducted by the travel agent operating the Government Travel Service. These also show a high

level of satisfaction with service. The Directorate and the Government Travel Service provide training and issue bulletins on contract requirements and the need to reduce travel costs.

7.104 In our view, information about how well the relationship works between the Government Travel Service and the government is limited. While surveys of public servants indicate satisfaction with agent performance, response rates of less than five percent preclude definitive assessment. Moreover, the surveys do not determine whether a traveller knows if he or she got the best possible fare. Departments are looking for added assurance that they are getting least-cost air fares. Since fare audits have been limited, and to give added assurance to departments, the Directorate plans to expand on-line fare audits during 1995 to see that the Government Travel Service provides the lowest possible fares. We note some confusion in departments over terms of the Government Travel Service contract and what individuals should do



The Government Travel Service working to arrange travel for public servants (see paragraph 7.100).

when they believe a least-cost fare has been missed.

7.105 Public Works and Government Services Canada should develop better ways of measuring the use of travel and progress toward a goal of least-cost travel.

Need for joint effort

7.106 The Treasury Board Secretariat and Public Works and Government Services Canada tend to operate separately in various aspects of travel management. They devote few resources to the area and occasionally exchange information.

7.107 With the emergence of new technology there is a potential to achieve savings by re-engineering activities and simplifying the travel administration process. Neither of the central agencies has carried out studies on how travel could be more efficient and economical. They have not joined forces to assess strategic alternatives; estimated any extra costs incurred as the result of the policy to travel by Canadian carriers; set up a plan to simplify travel administration; and helped to identify the information that would best meet the needs of departmental management. It is not clear whether such tasks are the responsibility of Public Works and Government Services Canada or the Treasury Board Secretariat.

7.108 Combined effort by these two central agencies would help improve travel arrangements and management. For example, assessing and introducing new strategies for air travel would require co-ordination and policy judgments between them. It seems an opportune time to manage travel in a more integrated way given the overriding issue of what government can afford.

7.109 As this audit report was being finalized, an interdepartmental Travel Working Committee and a steering committee of assistant deputy ministers began work in 1995, chaired by Treasury Board Secretariat, with a view to reduced costs of travel and travel administration. This should provide a means for central agencies and departments to clarify responsibilities and to work more closely together.

Hospitality – Tailoring Control to Risk

7.110 Departments spent \$24 million on hospitality in 1993-94. Foreign Affairs and International Trade spent \$10 million on hospitality for important protocol functions that are intended to help Canada maintain relationships with other countries. This includes the receiving and entertaining of foreign dignitaries. Departmental records show that Foreign Affairs and International Trade spent \$2.7 million on hospitality in Canada and \$7.7 million at 125 posts or offices abroad. Hospitality spending at posts ranged from \$1,000 in Miami to \$761,000 in Tokyo.

7.111 In the interest of avoiding travel costs, we confined our audit to headquarters in Ottawa and did not audit hospitality at posts abroad. Instead, we reviewed the findings of the Department's internal auditors.

7.112 Foreign Affairs and International Trade has recognized problems and is working to improve control over hospitality. Early in 1994, it issued revisions to a 23-year-old policy on hospitality outside Canada. The new policy provides standards for expenditure initiation, admissible expenditures, reporting and accounting. A next step is building management information to monitor and assess the benefit and cost of

Combined effort would help improve travel arrangements and management.

hospitality and to measure compliance with policies of the Department and the Treasury Board. Another weakness was found in the control over stocks in Ottawa, which could be improved by independent reconciliation procedures and reduction in stock levels. The Department told us that steps are being taken to solve these problems. It is too soon to tell if new measures are working. Our Office will conduct follow-up audits.

7.113 National Defence spent \$2 million on hospitality in 1993-94. It divides hospitality budgets among 90 account holders, including base commanders and generals. Most budgets are under \$1,500 each. Departmental regulations governing hospitality are complete, clear and effectively communicated. However, an internal audit reported in 1988 that the total cost of administering hospitality funds was about \$1 million. Our review of this calculation and of the current process indicates that estimated cost to still be valid. This is excessive given the low level of risk involved. The Department recently set up a team with a goal of reducing administrative orders by 50 percent over the next two years, covering all areas of administration, including hospitality.

Conclusion

7.114 In summary, government programs depend on travel and hospitality. The government is presented with a unique challenge to report information that would lead to a better understanding of travel. There are many opportunities to reduce costs and improve the management of travel and hospitality. This will require focussed effort and co-operation between central agencies and departments.

Response of the Treasury Board Secretariat: The observations and

recommendations of the Auditor General will be useful in helping the Treasury Board Secretariat achieve its goal of improving the management of government travel.

The Secretariat already has initiatives underway that will address many of the issues raised by the Auditor General.

The Secretariat has established two interdepartmental committees to provide suggestions on ways to reduce the costs of government travel. These committees are reviewing issues related to the Travel Directive and travel administration, raised by the Auditor General. They are also reviewing the travel practices of other governments and private sector employers. One committee is a senior level steering committee; the other, a working committee of travel and financial experts. Public Works and Government Services Canada are active participants on both committees.

Proposals for policy changes will be discussed with Public Service unions in the National Joint Council during the triennial review of the Travel Directive beginning in the fall of 1995. It will be the aim of the Secretariat to simplify the Directive and maximize savings over the full travel cycle.

Information system improvements and other technological applications, such as a Travel Expert System and ATM access using the Government Travel Card, are being pursued by the Treasury Board Secretariat with Public Works and Government Services Canada and departments.

Response of Public Works and Government Services: In anticipation of the Treasury Board's 1996 triennial review of travel, a departmental Travel Working Committee and separate Assistant Deputy Ministers steering committee, including PWGSC, have been struck. Their focus is on reducing the costs of travel and travel administration. The steering committee's mandate is to provide strategic direction

in terms of policy development and the administration of travel, including overseas travel. The objectives of this committee are: to identify means to reduce administrative costs related to travel; to find ways to make travel less expensive; to recommend changes to the Travel Directive to improve efficiency and reduce costs; and to identify data and support necessary for more effective management of travel by the traveller, the manager, within departmental responsibility centres, at the departmental level and across government.

A PWGSC 1994 periodic on-line fares audit indicated that the government travel contractor achieved an excellent performance in offering the lowest applicable fares. In February/March 1995, a fares audit was conducted by a leading airfare audit company involving all departments located in the National Capital Region plus Agriculture Canada in Vancouver B.C. Other similar on-line fare audits will follow during 1995 and will include regional offices as well.

The introduction of Rider's new ReportLink Plus system in the Department, during the next few months, should assist managers in developing reports specific to their needs, thus alleviating manual review of large reports.

Response of the Department of National Defence: *We agree with the general audit observation that the cost of travel administration in government can be*

reduced by automating and streamlining procedures. Our most recent cost saving measures are as follows:

- *the development and trial of a claims automation system;*
- *the introduction of statistical sampling techniques to reduce the number of claims requiring full audit;*
- *the implementation of a government-wide project to expand the use of the enRoute travel card to obtain advances through the automated teller machine (ATM), which will reduce and simplify the travel process and save interest charges; and*
- *DND, in conjunction with enRoute, is currently reviewing systems and databases in order to improve the quality of data being exchanged; this exercise should result in a streamlined and less labour-intensive billing, verification and payment process.*

Since the Office of the Auditor General completed the audit, National Defence now monitors the use of first class and business class bookings. Data are now available that shows that these bookings account for 3.5 percent of total commercial air travel. In monetary terms, this accounts for approximately \$2 million dollars or 5 percent of total commercial air costs. The remaining 96.5 percent of air travel tickets booked through National Defence were at full fare economy or a lesser fare.

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Chapter 8

Travel Under Foreign Service Directives

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Travel Under Foreign Service Directives

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Main Points

8.1 In our 1994 Report, we stated that the Department of Foreign Affairs and International Trade had investigated irregular travel claims submitted by employees under foreign service directives. Further, we indicated that we would follow up on the actions taken by the Department to rectify this problem and would report our findings in May 1995. Travel irregularities were first detected in 1988. A lengthy investigation was begun almost immediately and concluded in September 1994. The final disciplinary actions will be taken during 1995.

8.2 The investigation of travel irregularities by the Department was thorough and identified amounts were recovered. The disciplinary process was well managed and penalties were given for misconduct, mostly in the form of suspensions. This page in the Department's history can now be turned. It is more important to concentrate on the present and the future.

8.3 The Department must continue to work to improve its management of travel. Accountability for the results of foreign service directives needs further clarification by Treasury Board Secretariat in collaboration with affected departments. Decision making by the Department and the Treasury Board Secretariat could be supported by better analytical information.

8.4 In our 1994 Report, we observed that foreign service directives remained complex, and our long-standing concern about this has not been fully resolved. This chapter further illustrates that problem. Changes that were made in 1993 to foreign service directives have provided increased flexibility to employees in the use of travel allowances. The results of these changes, including cost savings, have yet to be assessed. The upcoming triennial review in 1996 should be used as an opportunity to do that. As reported in 1994, the need for a fundamental re-examination of the foreign service directives system remains as the larger challenge.

Introduction

Why This Audit Was Done

8.5 Public servants posted abroad are afforded entitlements under foreign service directives (FSDs). These include provisions for accommodation, relocation, education, leave and travel. Employees of the Department of Foreign Affairs and International Trade and of other government departments are users of these directives. For travel under FSDs, employees can make their own travel arrangements through either the central Government Travel Service in Canada or any other travel agency in Canada or abroad.

8.6 In our 1994 Report to the House of Commons, we noted that the Department had investigated irregular travel claims submitted by employees under foreign service directives. Further, we said we would follow up on the actions taken by the Department to rectify this problem and would report our findings in May 1995.

8.7 Because travel irregularities had taken place, we wanted to review the actions taken by the Department in dealing with them and the improvements introduced in travel management. We also wanted to consider the implications of subsequent changes to the foreign service directives that provide for travel when federal public servants are posted abroad.

Audit Objectives

8.8 The purpose of the audit was to provide assurance to Parliament on the actions taken by Foreign Affairs and International Trade in response to improper travel claims. This follow-up audit was to assess whether accountability

for, and control of, travel have improved since travel abuse was first discovered in 1988; specifically:

- to determine whether investigative and disciplinary measures were applied consistently and in accordance with the established criteria; and
- to determine whether the disciplinary measures and other management procedures and changes have reduced travel irregularities and/or reduced control risks.

8.9 This chapter builds on Chapter 22 of our 1994 Report, “Foreign Affairs and International Trade — Financial Management and Control”.

Scope and Approach

8.10 In completing this follow-up audit, we used information that was available from the Department and other information provided by the Treasury Board Secretariat. At no time did we obtain names of employees involved in travel irregularities.

8.11 We examined the coverage of travel claims investigated by the Special Projects Unit of Foreign Affairs and International Trade. We examined events subsequent to the investigations and assessed the disciplinary process for dealing with the affected employees of the Department.

8.12 The investigation of travel irregularities also identified problems with the travel claims of people who were employees of other departments and agencies. There were 25 employees of the Canadian International Development Agency and 17 employees in 10 other entities. Disciplinary action was the responsibility of those other entities. We did not include them in the scope of this audit.

8.13 We reviewed the investigation methods of the Special Projects Unit, including problem identification, preliminary investigation, development of investigation criteria and extending the scope of investigation. We reviewed with the Department the participation of airline companies, the International Air Transport Association, travel agencies, and the Royal Canadian Mounted Police in this process.

8.14 We reviewed the legal and delegated authority of the Deputy Minister of Foreign Affairs to establish the standards and discipline for employees that may be applied for misconduct or breaches of discipline. We examined the terms of reference of the Department's disciplinary committee, the disciplinary criteria and the disciplinary process followed by the committee. We reviewed with the Department the participation of the Treasury Board Secretariat and legal advisors from the Department of Justice. Audit results with respect to travel irregularities and disciplinary measures are contained in the first part of this chapter, paragraphs 8.19 to 8.44.

8.15 The travel management practices of the Department were reviewed. Our observations are contained in paragraphs 8.45 to 8.51.

8.16 Since irregularities took place under FSD 45 (foreign service leave) and FSD 50 (foreign service travel assistance) in particular, we reviewed changes made in 1993 to the rules for employee travel under these two foreign service directives. The audit did not include a detailed examination of the use of the two directives. As examples of the complexity of FSDs, we focussed on describing the directives and the information used to make changes to them and to foreign service directives in general. The results of our work are contained in the second

part of this chapter, paragraphs 8.52 to 8.108.

Observations and Recommendations

Action Taken on Travel Irregularities

Background information

8.17 Travel is a necessary part of delivering programs at Foreign Affairs and International Trade. The Department processes approximately 23,000 travel claims each year. In 1993-94 it spent \$32 million on operational travel, and a further \$14.5 million, approximately, on travel-related items under 7 different FSDs, made up primarily of vacation travel assistance (FSD 50), leave transportation (FSD 45), and family reunion travel (FSD 51). In addition, travel is provided as part of relocating employees under FSD 15.

8.18 In 1988, the Department discovered that certain employees were filing travel claims under the FSDs that were supported by false documents. It began an investigation and, after initially testing 281 claims, confirmed the problem. The investigation was expanded to cover claims made over a period of 51 months from 1 April 1986 to 30 June 1990.

The scope of investigation was appropriate

8.19 A Special Projects Unit was created to conduct an investigation of claims. Since 1993, the Unit has been part of the Office of the Inspector General for the Department of Foreign Affairs and International Trade.

8.20 The Unit designed criteria, a plan of action, and methodology to conduct the

investigation. It established that approximately 45,000 travel claims met the criteria and fell within the time period for investigation. This included travel under foreign service directives and duty travel out of Ottawa. It did not include claims for program related travel at missions abroad.

8.21 Among other procedures, the Unit confirmed the use of air tickets as claimed by employees. It sent 20,449 airline tickets to 125 airlines to confirm that they had been used. Of these, 5,955 were sent to the International Air Transport Association to confirm whether specific tickets claimed by employees had in fact been voided, or sold. The information received by the Unit was used to extract 7,269 travel claims for detailed examination of air travel. From these, 482 problematic claims were identified, involving 269 public servants and 5 non-government employees.

The investigation process was thorough and the findings supportable

8.22 Once an irregularity in a claim was found, the employee was informed that his or her travel claim was being reviewed. The employee had the opportunity to provide additional information, re-examine the travel claim with the Special Projects Unit and agree or disagree with the conclusions. All affected employees agreed to the findings,

subsequently submitted corrected and properly supported claims, and refunded the money owed to the Crown. A total of \$567,200 was recovered on all claims proved to be improper, including recoveries from employees who had subsequently retired.

8.23 The data on the number of individuals involved are displayed in Exhibit 8.1. The investigation disclosed that individuals achieved cash gains from various forms of manipulation. Most prominent was a practice known as “ticket cashing”, where the employee was reimbursed for a full-fare economy ticket although he or she had actually purchased and used a discounted economy fare ticket. Fourteen employees who had submitted travel claims were found not to have travelled at all.

8.24 The Special Projects Unit identified no irregularities in air travel arranged through the central Government Travel Service. Irregularities were found in bookings made through other travel agencies in Canada and in other countries.

8.25 The investigation found that 274 individuals had submitted improper claims. Of these, 227 had been employees of the then Department of External Affairs. This represented approximately 10 percent of some 2,200 departmental employees who had access to FSD travel. Of the 227 employees of the Department, 24 had retired. The remaining

Description	Number of Individuals
DFAIT employees	227
CIDA employees	25
Employees of other government entities (10)	17
Non-government employees	5
Total	274

Exhibit 8.1

Summary of the Number of Individuals Who Had Improper Travel Claims

Source: Office of the Inspector General – Department of Foreign Affairs and International Trade

The investigation found that 274 individuals had submitted improper claims.

203 comprise employees from all levels of the Department: support staff (125), officers (55) and executives (23).

8.26 Individuals who submitted irregular claims were at 67 locations, including locations in Canada. Individuals at non-hardship locations — such as Ottawa, London, Paris, Canberra — represented 58 percent of the improper claims. Approximately 22 percent had been filed by individuals who were at posts with the highest level of hardship.

8.27 Employees of the Department claimed improper travel expenses under seven different foreign service directives. Travel under FSD 45 (foreign service leave) and FSD 50 (foreign service travel assistance) were the most prominent. Travel irregularities under these two directives accounted for 57 percent of the number of improper claims and 82 percent of the dollar amount (\$462,561) recovered from all individuals, including employees of the Department. This led us to review subsequent changes made to these foreign service directives in 1993.

Investigation reporting was continuous and complete

8.28 The Special Projects Unit kept senior management of the Department informed on a continuing basis. The Department shared summary information with the Treasury Board Secretariat, the Office of the Comptroller General, the Office of the Auditor General, the Department of Justice and the Royal Canadian Mounted Police.

8.29 While the investigation was in progress, the Deputy Minister of the Department at that time kept all employees informed about the circumstances. An information bulletin served as a general reminder about the expected conduct of employees and the

seriousness of misconduct. The names of affected employees were kept confidential.

8.30 The Special Projects Unit forwarded claims information to the RCMP for review. The RCMP selected 15 claims for investigation to establish whether there was sufficient evidence to lay criminal charges. After initial consultation with Ontario's Crown Attorney, the RCMP investigated these claims over a period of 13 months. The RCMP concluded that charges could be laid, and again consulted with the Ontario Crown Attorney. In April 1993, the Ontario Crown Attorney advised that charges would not be laid for the following reasons: pre-trial delay; restitution had been made by all concerned; it was not in the public interest to embark on a lengthy and costly prosecution; and incidents were seen to be primarily a management-employee issue.

8.31 The Department's investigation focussed on air travel. Claims with irregular air tickets were also audited to ensure that other travel expenses were legitimate, and many amendments were made and funds recovered. For practical reasons, the Unit could not examine all claims that might have involved air travel. For example, airlines retain data records of used tickets for limited periods, usually 18 to 24 months. The investigation could not deal with employee claims if the tickets were too old. Subject to this constraint, the investigation would have detected most of the travel irregularities within the scope of investigation.

Conclusions

8.32 The claims investigation was well executed within its scope. Because the Department has not completed a test of travel claims filed by employees since June 1990, we are unable to determine whether or not the irregularities involving

“ticket cashing” have stopped. The Department has informed us that it began a follow-up audit in November 1994 and that it will be completed in 1995.

The disciplinary process was appropriate

8.33 Although the identified amounts of \$567,200 were recovered, submitting improper claims was considered to be misconduct. Senior management asked the Department’s disciplinary committee to act. This committee was chaired by the Assistant Deputy Minister, Personnel. The committee’s terms of reference were set out clearly and concisely. A sub-committee was struck, chaired by the Deputy Inspector General, to deal with travel irregularities. Disciplinary criteria were set after seeking advice from senior managers in the Department and in Treasury Board Secretariat’s staff relations section.

8.34 On receipt of the dossier from the Special Projects Unit, the sub-committee and the Secretary of the disciplinary committee reviewed the cases. To meet the requirements of the fairness principle, interviews were arranged. All affected employees were asked the same set of questions and given the opportunity to give their version of events. At headquarters in Ottawa, these interviews

were conducted by the sub-committee, and at missions abroad by either the Head of Mission or another senior officer.

8.35 There were 227 employees involved in the irregularities. Of these, 24 had retired and 199 were dealt with by the disciplinary committee. At the time of our audit, only 4 cases were pending.

Records of disciplinary measures were kept

8.36 A summary of disciplinary measures recommended by the committee is displayed in Exhibit 8.2. A total of 1,543 days of suspension were given out to 141 employees at an estimated loss of pay totalling approximately \$276,000. A record of suspension was to stay on an employee’s personnel file for two years, after which it was to be removed. Disciplinary actions against the remaining employees included, for example, reprimands to 53 of them. In addition, five people paid fines totalling \$12,750. No disciplinary or other actions were taken against 24 people who had retired, but funds were recovered from them.

8.37 When deciding on disciplinary measures, the committee applied disciplinary criteria and considered any mitigating or aggravating circumstances such as position of trust, length of service, previous disciplinary record and

The claims investigation was well executed within its scope.

Level of Discipline	Disciplinary Measures	Number of Employees
1	Oral reprimand	51
2	Written reprimand	2
3	Suspension 1–10 days	61
4	Suspension 11–20 days	54
5/6	Suspension 20–36 days	26
Other	Retired in due course (24), voluntary retirements (1), fines (4). Pending cases (4)	33
Total		227

Exhibit 8.2

Summary of Disciplinary Measures For Employees of Foreign Affairs and International Trade

Source: Staff Relations Section – Department of Foreign Affairs and International Trade

The disciplinary process was well managed and various penalties were given for misconduct.

restitution made. The committee made recommendations to line managers to suspend affected employees for a specified number of consecutive days without pay. The decision to implement a suspension was made by each employee's line manager as recommended by the committee.

8.38 The official position of the Department was that all disciplined employees had to serve their suspensions without pay, away from the employer's premises and within 90 days. The disciplinary committee's recommendation of suspension was communicated to the line manager or supervisor of each affected employee. The supervising manager had the final responsibility to act, ensuring that the suspension was carried out in accordance with policy. The supervisor communicated to the disciplinary committee the dates on which the affected employee was to serve the suspension, and pay was to be deducted accordingly.

Disciplinary measures help reduce risks, but effects may not last

8.39 A suspension from duty has two related aspects. First, the employee is not to be on the employer's premises. The second aspect is pay deduction. Allowances provided under foreign service directives were not affected by suspension.

8.40 We were able to establish that the pay was deducted and the Department followed prescribed government procedures for discipline. These procedures did not require feedback to the disciplinary committee to know if all suspensions had conformed with official policy of the government.

8.41 In our view, discipline is a factor that influences behaviour and values.

Given the seriousness of the travel irregularities and the public interest in this, special additional measures could have been taken to ensure that no doubt could exist for all concerned that all suspensions were served as required. We observe that an additional step of requiring supervisors to confirm that suspensions had been served as required would have provided complete assurance.

8.42 The imposition of discipline for improper behaviour and breach of trust can serve as a strong deterrent to future misconduct. In addition to loss of pay, chances for advancement can be diminished.

Conclusions

8.43 In dealing with the cases, the disciplinary process was well managed and various penalties were given for misconduct.

8.44 The occurrence of travel irregularities was an unfortunate event in the history of the Department. This story can be closed and the page turned. It is now more important to concentrate on the present and the future.

Management of travel requires improvement

8.45 The kind of travel irregularities that took place would not be fully preventable through formal controls. They were indications of a problem in the culture of the Department, which includes ethics and values. Investigation and discipline were important actions to help strengthen the control environment of the Department. However, they are also temporary in nature.

8.46 In addition to investigation and discipline, we looked for improvement in the Department's management of travel, to help ensure that similar or other problems were avoided and to provide

assurance that travel was being managed with due regard to efficiency and effectiveness.

8.47 Since 1992, audit findings point to continuing problems in the management of travel. Examples include lack of reports to management on the use and costs of travel, high error rates in filing and processing travel claims, little analysis of error rates, backlog of claims for account verification, problems in account verification, excessive travel advances and claims not submitted on time.

8.48 The Department informs us that steps have recently begun to improve its management of travel. Also, the Department has recently completed an internal audit of travel with a final report pending.

8.49 In our view, the Department needs a comprehensive plan, supported by senior management, to improve travel management as a whole. This should be aimed at improving decision making at all levels and improving the overall level of control.

8.50 Elements of such a plan might include the redesign of the travel administration process, determination of management information needs and reports, assessing need for travel and ways of reducing travel costs, statistical sampling of travel claims for verification based on risk assessment, and increased training for all employees on minimizing travel costs while maintaining program effectiveness.

8.51 The Department of Foreign Affairs and International Trade should continue with its efforts to implement a plan that would improve the management of travel.

Changes in Foreign Service Directives

Introduction

8.52 As noted earlier in paragraph 8.27, almost all of the irregular claims identified by the Department were related to travel under seven foreign service directives, including travel related to relocation, leave transportation, and travel assistance. Our work on actions taken by the Department to address travel irregularities required us to understand the changes that were made in 1993 to FSD 45 (foreign service leave) and FSD 50 (foreign service vacation travel assistance). We did not conduct a detailed examination of the use of these directives. Rather, we reviewed the process and information used to change them and foreign service directives in general. In so doing, we have considered the implications of changes in entitlements.

Background information

8.53 In 1994 we reported that foreign service directives (FSDs) are complex. The following information illustrates this, in particular by describing FSD 45 and FSD 50. For further information and description of FSDs, readers are referred to Chapter 22 of our 1994 Report.

8.54 There is a long history to the evolution of FSDs. Over many years, they have been transformed from regulations prescribed by the government to negotiated entitlements. On a three-year cycle, the Treasury Board as employer negotiates them with representatives of government employees.

8.55 FSDs are based on three principles: **comparability**, **incentive/inducement**, and **program-related**. Incentives, for example, are intended to induce service abroad by compensating employees and

The Department needs a comprehensive plan, supported by senior management, to improve travel management as a whole.

In 1994 we reported that foreign service directives (FSDs) are complex.

their families for potential “disutilities” and hardships. A foreign service premium (FSD 56) is paid to all employees serving abroad; this allowance is tax-free and increases with salary level, family size and months of service abroad. Additional foreign service leave credits (FSD 45) are provided for each month of service abroad. Vacation travel assistance (FSD 50) is provided to employees and their family members resident abroad. This benefit is provided with greater frequency for locations of increased hardship.

8.56 The net expenditures under FSDs are shown in Exhibit 8.3 according to the principle that governs them. FSDs cover as many as 100 topics relating to shelter, relocation, health, education, compensation, and travel. They are available to approximately 1,700 Canada-based staff at over 140 locations abroad who are operating under differing levels of hardship.

Approximately 64 percent of Canadian-based staff serving abroad are employees of Foreign Affairs and International Trade.

8.57 FSDs 45 and 50 emerged in their present form in 1982. Previously there had been various provisions for “Canadian leave”, which assisted employees and their families to return to Canada. The idea was to bring home to Canada employees who were serving Canada abroad. This would allow them to reacquaint themselves with Canada and enjoy familiar surroundings while getting away from the confines and difficulties of a foreign post. The historical notion of “re-Canadianization” is no longer the exclusive purpose of FSDs 45 and 50. Today, employees may take rest and recreation holidays in any part of the world and are not required to use their entitlements to return to Canada.

Exhibit 8.3

FSD Expenditures by Guiding Principle
(\$ millions – nominal)

Guiding Principle	1991-92	1993-94	Increase (Decrease) Percentage
Comparability			
FSD 25 – Shelter	49.2	52.9	7.5
FSD 34 – Education Allowance	8.5	9.9	16.5
FSD 55 – Salary Equilization	7.9	11.0	39.2
11 Other FSDs	5.1	4.7	(7.8)
	70.7	78.5	
Incentive/Inducement			
FSD 45 – Foreign Service Leave	3.5	3.7	5.7
FSD 50 – Foreign Service Vacation Travel Assistance	7.1	8.4	18.3
FSD 56 – Foreign Service Premium	17.3	16.2	(6.4)
FSD 58 – Post Differential Allowance	7.7	7.1	(7.8)
	35.6	35.4	
Program Related			
FSD 15 – Relocation	25.3	29.7	17.4
7 other FSDs	1.5	0.9	(40.0)
	26.8	30.6	
Total FSD Expenditures	133.1	144.5	

Source: Supply and Services
Report # 9005

8.58 As an incentive for serving abroad, FSD 45 provides the employee with an additional 10 days of foreign service leave per year. The employee has three options to use FSD 45 leave credits: take time off work; cash out leave credits at the employee's rate of pay in effect at 31 March; or trade 10 days for a transportation allowance. Trading the leave for salary is deemed taxable and requires issuance of T4 or T4A tax forms.

8.59 Employees who choose to surrender 10 days of leave for a transportation entitlement receive an entitlement equal to 85 percent of the cost of a full-fare economy air ticket from the post to Ottawa and return. The employee must be at post when trading leave for a transportation entitlement. The transportation entitlement is not subject to income tax. The employee can take parts of the entitlement on more than one occasion over a year and it can be used by more than one person. For example, employees may travel or may arrange to have family members travel to their posts to visit them. Although the entitlement is based on the price of air fares, travel by air need not necessarily take place.

8.60 Transportation for which an employee can be reimbursed includes all forms of commercial transport. Departmental instructions make the distinction between commercial and recreational transportation. For example, the cost of using camper vans and houseboats as transportation would be claimable, while canoes and bicycles would be considered recreational expenses and would not be admissible under FSD 45. A travel advance must be accounted for and is to be settled soon after the trip is completed, or within one year from issuance of an advance.

8.61 Any foreign service leave that an employee does not use will accumulate.

FSD 45 leave can be taken or cashed at any time. Expenditures under FSD 45 amounted to \$3.7 million in 1993-94.

8.62 FSD 50 was created in 1982 to provide a travel allowance that would enable an employee and dependants to visit Canada or elsewhere during their posting, within the overall cost entitlement.

8.63 While serving at a post, the employee and dependants are entitled under FSD 50 to the value of a return air journey between the post and headquarters (normally Ottawa). The number of times an entitlement can be used depends on the hardship level assigned to the post. Vacation travel assistance must be used only when posted abroad, and within a prescribed period, or it lapses. An employee who uses an FSD 50 entitlement must take a minimum of 10 days off work. Expenditures for travel under FSD 50 amounted to \$8.4 million in the fiscal year 1993-94.

Changes in foreign service directives 45 and 50

8.64 Conditions for using FSD 45 were modified in 1993. Exchanging leave credits for cash can now be done more than once a year. In addition, the employee is now given up to one year to account for a transportation advance. The transportation entitlement payable under FSD 45 was set at 85 percent of a standard full economy return air fare between post and headquarters. Previously, an employee could claim travel expenses up to the equivalent of 100 percent of a full economy return fare.

8.65 In 1993, the title of FSD 50 was changed from "foreign service travel assistance" to "foreign service vacation travel assistance", introducing the option of a non-accountable vacation travel allowance. Although employees may

travel to any destination, the Department expects that assistance under FSD 50 will be used for travel away from the immediate post area (usually a city). Employees are not required to leave the country of posting, but may if they wish.

8.66 Employees still have the option to claim travel expenses up to the equivalent of 100 percent of a full economy-class return air fare. This entitlement is provided on an accountable basis; employees must submit receipts to support travel claims. If employees choose a non-accountable payment, they receive the equivalent of 80 percent of a full economy-class return air fare between post and headquarters (or 90 percent if stopover is normally required) for the employee and each dependant. Employees are not required to submit receipts in support of these payments. While an accounting for the use of funds is not required under the new option, the Deputy Minister may seek confirmation that travel has taken place.

8.67 While the older accountable option required that the funds be spent on transportation and stopover costs, the new option permits the use of funds for vacation more generally. It allows, for example, foreign service families to take travel package tours, which previously was not allowed.

8.68 In making such changes, the Treasury Board expected to provide greater flexibility to employees, reduce the balance of accumulated leave credits under FSD 45, reduce the cost of FSD 50 entitlements, and reduce the number of travel claims, thereby reducing the cost of administration.

Accountability for the results of foreign service directives

8.69 The Treasury Board is a legislated committee established by the *Financial Administration Act* and is comprised of six ministers. As the employer, the Treasury Board is ultimately responsible for the foreign service directives. Benefits under FSDs are negotiated through the National Joint Council and approved by the Treasury Board. The Treasury Board Secretariat is responsible for FSD policy and is accountable for FSD policy formulation.

8.70 The Department of Foreign Affairs and International Trade is responsible and accountable for the administration of FSDs. The Department processes the claims and is required to interpret and apply the directives. In this sense, the Department plays a custodial role. The Department is also responsible to provide information about FSDs to the Treasury Board Secretariat.

8.71 In our 1994 Report we raised concerns about FSD complexity, cost control and whether FSDs achieved their stated intent. We concluded that effecting change in this would require a fundamental re-examination of the FSD system, how it is managed and the controls in place to ensure value for money. As part of this, it would be helpful if the parties established among themselves their respective accountability for FSD results.

8.72 The Treasury Board Secretariat, in collaboration with departments with employees subject to foreign service directives, should further clarify their respective accountability for the results of foreign service directives.

Non-accountable payments

8.73 For a number of years, employees have sought increased flexibility in their travel entitlements. For example, a provision for non-accountable payments under FSD 50 had been proposed prior to 1989. However, it had not been negotiated because the update of FSDs scheduled for 1990 was deferred. The 1993 update of FSDs provided the first opportunity to introduce non-accountable payments under FSD 50.

8.74 In 1991, the Treasury Board gave the Secretariat authority to proceed with negotiating non-accountable payments under FSD 50. Decision makers were informed that such a provision could be open to criticism in the wake of the travel irregularities. However, they considered that the expected benefits of cost reduction and simplicity would exceed this risk.

8.75 Beginning in 1993, and on a trial basis, employees can receive a non-accountable payment for vacation travel based on 80 or 90 percent of a full economy fare return ticket and are free to arrange the destination or mode of travel they may wish. The process to assess the change began in February 1995, when we were completing this audit.

8.76 We understand that, under previous policy rules, employees could be left "out of pocket", or "transportation-rich, but travel-poor". That is, although they received allowances based on transportation, they might incur additional costs of travel that were not reimbursed. A non-accountable payment option under FSD 50 helps resolve this concern by providing employees with increased flexibility. In the process, the directive has been transformed from providing transportation to also being a means by

which employees can potentially realize cash compensation.

8.77 The introduction of non-accountable payments under FSD 50 removes restrictions on using an entitlement that apparently were considered by employees to be unfair or illogical. Through this change, a stronger incentive has been provided to secure and retain employees in foreign service.

8.78 Between June 1993 and June 1994, employees filed 1,485 claims pursuant to FSD 50. Seventy percent of the entitlement claims were met by a non-accountable payment. This indicates that the new non-accountable payment option is attractive to employees.

8.79 The pending assessment of FSD 50 will be important for determining not only the effects of changes in FSD 50 but also the future direction of FSDs as a whole, in terms of how they can be simplified, provide flexibility and reduce costs, all while achieving accountability and control for results.

Better information and communication needed

8.80 We observed in our 1994 Report that expenditures related to foreign service directives have been rising annually by an average of 9 percent per employee since 1988-89. The costs associated with providing compensation to employees abroad are rising without sufficient review.

8.81 In September 1991 the Treasury Board authorized the Secretariat to negotiate foreign service directives. As part of this mandate authorization, maximum additional FSD costs (excluding accommodation entitlements) were not to increase by more than a specified percentage or amount. However, such limits are not intended to control actual FSD expenditures as a whole.

A stronger incentive has been provided to secure and retain employees in foreign service.

Although data are available, the problem is in assembling analytical information useful for decision making.

8.82 We have determined that total FSD expenditures, net of accommodation, increased by a total of \$7.7 million between fiscal years 1992 and 1994. In particular, expenditures under FSD 50 did not decrease as expected, but increased by 16.6 percent.

8.83 Although data are available, the problem is in assembling analytical information useful for decision making. We found differences between the Treasury Board Secretariat's and the Department's expectations of costs and savings from the changes in FSDs. In 1991 the Treasury Board Secretariat anticipated savings in FSD 50 costs, but did not estimate them since it considered cost savings to be dependent on what was negotiated. Long-term savings in FSD 45 leave credits were anticipated but were not estimated, since they were considered dependent on patterns of usage. The Department anticipated, although no detailed costing had been done, that there would be no cost increases or decreases as the result of its FSD 45 and 50 proposals.

8.84 Although data are used to guide FSD negotiations, neither the Treasury Board Secretariat nor the Department forecast the FSD budget for future years. As a result, estimated expenditures are uncertain, including those for FSD 45 and 50. The opportunity was not taken at the close of negotiations and before changes were implemented to analyze the prospective behaviour of total FSD use and costs. FSD 50 expenditures increased by \$1.2 million (16.6 percent) over the two fiscal years 1993 and 1994. Expenditures under FSD 45 increased by only \$262,000 over the same two-year period. We found no monitoring of FSD expenditure and use trends, or explanations of the reasons for the expenditure increases. The Treasury Board Secretariat has begun an analysis of

this. For example, FSD 50 costs may have increased because of an approximate 8 percent increase in the price of international air fares.

8.85 FSDs are complex and expenditures will vary according to many factors. We do not suggest that analysis of trends is easy. For example, they will vary with changes in the value of the Canadian dollar. Between 1992 and 1994, the Canadian dollar declined 14.7 percent against the American dollar. They are also affected by the cost of living in other countries, a change in the number of employees serving abroad, the frequency of employee postings and the family profile of employees serving abroad. When FSDs are being reviewed, the Treasury Board Secretariat and the Department will need more sophisticated analysis to determine the operational and cost effects of foreign service directives.

8.86 Finally, although making comparisons with other governments is not essential for deciding how foreign service directives should apply in the Canadian government, decision makers might find such information useful. We note from our research that it is unusual for other governments to provide their employees serving abroad with a non-accountable cash payment for purposes of vacations or vacation entitlements at the same levels as in Canada.

Analytical capability is needed

8.87 Foreign service directives are complex, and sufficient information and analytical capability to manage them are not in place. Developing improved analysis would not be simple or without cost. Without it, however, decision making has to rest more on assumptions and speculation about costs and benefits. The following illustrates the complexity

of analyzing data to provide better information for decision making.

8.88 The way FSD 45 works could potentially increase costs. For example, leave credits earned while posted close to Ottawa can be traded for transportation allowances at a higher value while posted far from home.

8.89 According to Treasury Board documents, as of March 1991 there were 78,878 days of accumulated foreign service leave credits. The Treasury Board Secretariat anticipated in 1991 that proposed changes would encourage a reduction in the balance of leave credits under FSD 45. The size of the reduction was considered to depend on the pattern of use, and was not estimated. Analysis of patterns of use have not been done.

8.90 According to recent data we obtained from the Department, the balance of accumulated credits as of February 1995 was 21,736 days. This suggests a reduction of 57,142 days, or a reduction of 72 percent over four years. However, there is uncertainty as to whether current data (21,736) are comparable to previous data (78,878). For example, the changes may be due to the transfer of foreign service officers to other departments and agencies. If the data are reasonably correct, Canada-based staff serving abroad have taken (or converted to cash or transportation allowances), on average, more than 20 days each year under FSD 45. This is more than double the rate of 10 days per year at which leave allowances are earned.

8.91 Lack of information and analysis makes a reduction difficult to reconcile or to attribute to particular causes. Changes to FSD 45, combined with those to FSD 50, may have accelerated the rate at which leave credits are used. There may be other factors involved. An analytical

capability would help provide answers to such questions.

8.92 An FSD 50 entitlement was reduced from the maximum of a full-fare economy return ticket to the equivalent of 80 or 90 percent of a full-fare economy ticket. Logically, this would reduce the cost per event up to 20 percent, since employees were previously entitled to 100 percent. However, total expenditures under FSD 50 have been rising each year. Analysis is needed to explain this divergence. The Treasury Board Secretariat has begun an analysis.

8.93 The Treasury Board Secretariat attempted to reduce the complexity of FSD 50 and the costs of administration by introducing non-accountable advances. In making this change, it should be recognized there is a balance to be achieved between these goals and the potential financial incentive for employees.

8.94 Exhibit 8.4 provides examples of the financial incentive resulting from price differences between a full-fare return economy ticket (between post and headquarters) and a discounted economy fare. Any incentive realized will vary according to location, prevailing air fare prices, where and how an employee chooses to travel, and the number of the employee's dependants.

8.95 For example, employees posted at locations with the same hardship rating may be achieving different compensation results. Brussels and Tokyo are both rated as 0-hardship posts. However, an employee in Brussels can potentially realize a cash benefit of \$2,236 while an employee posted in Tokyo might realize \$3,757, due to the difference in air fare prices.

8.96 We were unable to find the basis or rationale for the 80 percent and

90 percent ratios, or alternatives that had been considered. These rates were agreed with bargaining agents for employees. We are informed that although the Treasury Board Secretariat's objective was to reduce the potential liability under the then-existing policy, the specific percentage reduction in entitlement was the result of negotiation.

8.97 In summary, although data are available, the means to identify and analyze the use patterns and costs of FSDs are limited. It is likely that there are a number of reasons why costs went up in the short term but may decrease over the long term. Without an enhanced analytical capacity in the Department and the Treasury Board Secretariat, there is no information to determine whether present

and future changes to foreign service directives result in progress toward a more efficient and effective system of entitlements.

8.98 In coming to the conclusion that additional information and analysis are needed, it is recognized that additional costs can be incurred. We are not suggesting that additional full-time staff be engaged. Rather, we suggest that consideration be given to acquiring the capability on an as-required basis.

8.99 In accordance with their policy and operational responsibilities, the Treasury Board Secretariat and the Department of Foreign Affairs and International Trade should improve their capability to gather and analyze

Exhibit 8.4

Travel under FSD 50 The Financial Incentive

Post Hardship Rating	Post	Full "Y" or "Y2" Air Fare *	FSD 50 Non-Accountable Advance @ 80%, 90% or 100%	Discounted Ticket Fare **	Per Ticket Difference
0	Brussels	\$ 4,908	\$ 3,926 (80%)	\$ 1,690	\$ 2,236
0	Tokyo	7,332	5,866 (80%)	2,109	3,757
0	Paris	4,441	3,553 (80%)	1,270	2,283
0	London	3,716	2,973 (80%)	926	2,047
I	Buenos Aires	3,824	3,442 (90%)	1,724	1,718
I	Singapore	5,849	5,264 (90%)	3,234	2,030
II	Budapest	3,366	3,029 (90%)	1,116	1,913
II	Hong Kong	3,438 (Y2)	3,438 (100%)	2,385	1,053
III	Manila	3,051 (Y2)	3,051 (100%)	2,360	691
IV	Moscow	5,244	4,720 (90%)	2,001	2,719
V	Islamabad	3,972	3,575 (90%)	1,707	1,868

* "Y" is standard economy-class fare; "Y2" is special economy-class fare on designated routes where there is no full "Y" economy-class fare.

** Discounted ticket fare represents a lower-than-full economy fare. Some restrictions may apply such as booking in advance of trip and staying a minimum number of days in Ottawa.

Source: Information obtained from the Government Travel Service. Prices reflect return air fares from above cities to Ottawa. Prices exclude all taxes and are based on published prices in effect on 13 April 1995.

information on the use patterns and costs of foreign service directives.

Simplification and reduced administration are goals yet to be assessed

8.100 The provision of non-accountable payments under FSD 50 eliminated the need to prepare, submit and process travel claims. Logically, this should reduce the administrative time necessary to prepare and check claims. At the same time, FSDs 45 and 50 were made more complex by the introduction of more options.

8.101 The Department processes over 23,000 claims a year for operational travel as well as travel under FSDs. The 1,000 or so claims eliminated by way of non-accountable payments under FSD 50 should help reduce the cost of administration. However, since employees may now take any portion of FSD 45 leave entitlements during a year, the cost of FSD-related administration could increase. The Department has yet to establish that it has made efficiency gains in administration as the result of the FSD changes introduced in 1993.

8.102 As part of the next three-year review, the Treasury Board Secretariat, supported by the Department of Foreign Affairs and International Trade, should assess the impact of the changes that were made to foreign service directives in 1993. In particular, they should examine the results of non-accountable payments.

Income tax treatments require review

8.103 The tax status of foreign service directives is an additional area of complexity. Taxability of benefits under the FSDs was initially reviewed by Revenue Canada in the late 1970s and

early 1980s. At that time, only two of the benefits were considered taxable.

8.104 In 1991, the Treasury Board Secretariat requested confirmation from Revenue Canada that certain proposed non-accountable allowances for relocation travel, and the conversion of the repayment or reimbursement of actual and reasonable travel expenses to a non-accountable allowance for vacation travel, would be considered to be non-taxable allowances. Revenue Canada indicated that such allowances would be non-taxable, by reason of a provision of the *Income Tax Act* that exempts representation or other special allowances received by public servants for a period of absence from Canada. Accordingly, amounts paid to employees as non-accountable allowances are not reported on employee T4s or T4As.

8.105 In August 1994, Revenue Canada was asked whether all or part of the benefits available under ten FSDs were taxable benefits for which T4s or T4As should be issued, or whether they were exempt under the specific provisions of the *Income Tax Act*. Revenue Canada's immediate attention was drawn to FSD 45 and 50. At the time of our audit, Revenue Canada had not yet initiated the requested review. We note that non-accountable payments under FSD 50 are not based on actual costs of vacation travel incurred by the employee, but are based on the market price of air fares.

8.106 The non-taxability of the benefits provided under the FSDs confers an additional benefit to employees. It is not clear that the exemption in the *Income Tax Act* was intended to cover the types of allowances that are currently being paid to public servants serving abroad. The tax treatment of FSDs is an important factor that should be considered by those responsible for determining FSD benefits.

The tax status of foreign service directives is an additional area of complexity.

The request for a ruling is appropriate and timely given the upcoming triennial review of FSDs.

8.107 A review of the tax treatment of foreign service directives should be included in the next triennial review.

Conclusions

8.108 In our 1994 Report, we observed that foreign service directives remained complex, and our long-standing concern about this has not been fully resolved. This chapter further illustrates that problem. Changes that were made in 1993 have provided increased flexibility to employees. The results of these changes, including cost savings, have yet to be assessed. The upcoming triennial review in 1996 should be used as an opportunity to do that. As reported in 1994, the need for a fundamental re-examination of the FSD system remains as the larger challenge.

Response of the Treasury Board Secretariat relating to its area of responsibility: The Auditor General's report contains a number of positive

observations and recommendations regarding the process and information used by the Treasury Board Secretariat to change the Foreign Service Directives.

The Secretariat and the Department of Foreign Affairs and International Trade will continue to work together to improve information and management of the FSDs.

As noted by the Auditor General, however, the means to identify and analyze the use patterns and costs of the FSDs are limited. This situation is made more complex by fluctuations in currency exchanges around the world.

Proposals for policy changes will be discussed with public service unions in the National Joint Council during the triennial review of the Foreign Service Directives beginning in the fall of 1995. Notably, experience with changes to FSD 45 and 50 will be closely examined. The issue of the tax treatment of the FSDs will also be considered. It will be the aim of the Secretariat to simplify the Directives and effect maximum savings.

It must be emphasized that any changes to the FSDs are subject to the concurrence of the bargaining agents within the National Joint Council.

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